Supreme Court, U.S.
FILED

031252 MAR 2 - 2004

OFFICE OF THE CLERK

No. _____

In The
Supreme Court of the United States

DICK CORPORATION and GE SUPPLY COMPANY,

Petitioners,

v.

MELLON BANK, N.A.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

LAWRENCE G. MCMICHAEL
Counsel of Record
MARTIN J. WEIS
VIRGINIA H. MCMICHAEL
DILWORTH PAXSON LLP
1735 Market Street, Suite 3200
Philadelphia, Pennsylvania 19103
(215) 575-7000
(215) 575-7200 (fax)

CHARLEYNE L. GABRIEL
KUNZ & OPPERMAN, P.C.
1750 First Indiana Plaza
135 North Pennsylvania Street
Indianapolis, Indiana 46204
(317) 684-6060
(317) 684-6061 (fax)

Attorneys for Petitioners

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED

1. Can a debtor in a bankruptcy proceeding convey to a secured creditor the right to recover a preference, for the sole benefit of the secured creditor, pursuant to Section 550(a) of the Bankruptcy Code, 11 U.S.C. §101 *et seq.*, which allows a trustee or debtor-in-possession to "recover, for the benefit of the estate" property that was preferentially transferred under Section 547 of the Code?

2. Can the statutory authority that Congress conferred on a trustee, debtor-in-possession, or a representative of the estate appointed under a confirmed plan, also be exercised by a secured creditor, acting in the debtor's stead, for its own benefit?

3. Is it a "recovery, for the benefit of the estate," for a secured creditor to provide financing to a bankruptcy estate for the sole purpose of financing a sale of a going concern where all proceeds of the sale will go to the secured creditor?

PARTIES AND CORPORATE DISCLOSURE STATEMENT

Petitioners (appellees below) are Dick Corporation and GE Supply Company. Dick Corporation is a non-public company that is a wholly owned subsidiary of Dick Enterprises, Inc. No publicly held company owns 10% or more of Dick Enterprises, Inc.'s stock. GE Supply is a division of General Electric Company, which is a New York corporation and publicly traded.

Respondent is Mellon Bank, N.A., as agent for the following prepetition senior lenders of Qualitech Steel Corp:

Bank Austria Creditanstalt
Bank of America
Banque Nationale de Paris (nka BNP Paribas)
Comerica Bank
Harris Trust and Savings Bank
Kreditanstalt für Wiederaufbau
LaSalle Bank, N.A.
Mellon Bank, N.A.
National City Bank, Indiana
The Sanwa Bank, Limited
Westdeutsche Landesbank Girozentrale
Keybank Corporation
Credit Suisse/First Boston
GATX Capital Corp.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
PARTIES AND CORPORATE DISCLOSURE STATEMENT	ii
TABLE OF CONTENTS	iii
TABLE OF AUTHORITIES	vi
PETITION FOR WRIT OF CERTIORARI	1
CITATIONS OF REPORTS OF OPINIONS ENTERED IN THE CASE	1
BASIS FOR SUPREME COURT JURISDICTION	1
STATUTES INVOLVED	2
STATEMENT OF THE CASE	3
REASONS FOR GRANTING THE WRIT	6
I. This Court Should Grant The Writ Because The Seventh Circuit's Opinion Permitting A Secured Creditor To Recover A Preferential Transfer For Its Own Benefit Is Contrary To The Plain Language Of Section 550 Of The Bankruptcy Code And Has Widespread National Implications	8
II. This Court Should Grant The Writ Because The Seventh Circuit's Opinion Permitting Mellon To Pursue A Preference Action Is Either Contrary To This Court's Decision In *Hartford Underwriters* Or Presumes The Answer To The Question Reserved In *Hartford Underwriters*	11

TABLE OF CONTENTS – Continued

Page

III. This Court Should Grant The Writ Because The Seventh Circuit's Decision Will Impact The Fundamental Economics Of The Bankruptcy Process To The Detriment Of Unsecured Creditors 14

CONCLUSION 18

APPENDIX

Court of Appeals Opinion: *Mellon Bank, N.A. v. Dick Corporation and GE Supply Company*, 351 F.3d 290 (7th Cir. 2003) ..... App. 1

Judgment Dated December 4, 2003 ..... App. 8

Order Dated May 9, 2003: *In Re Qualitech Steel Corporation*, 2003 U.S. Dist. LEXIS 9427 (S.D. Ind. May 9, 2003) ..... App. 9

Finding of Fact and Conclusion of Law Regarding Summary Judgment Motions: *Mellon Bank v. Dick Corporation*, Adv. No. 00-296; *Mellon Bank v. GE Supply Company*, Adv. No. 02-298 (Bankr. S.D. Ind. 2001) ..... App. 57

Order Granting Defendants' Motion For Summary Judgment: *Mellon Bank v. Dick Corporation*, Adv. No. 00-296; *Mellon Bank v. GE Supply Company*, Adv. No. 02-298 (Bankr. S.D. Ind. 2001) Dated August 6, 2001 ..... App. 85

Order Denying Plaintiff's Motion For Reconsideration: *Mellon Bank v. Dick Corporation*, Adv. No. 00-296; *Mellon Bank v. GE Supply Company*, Adv. No. 02-298 (Bankr. S.D. Ind. 2001) Dated December 27, 2001 ..... App. 87

TABLE OF CONTENTS – Continued

Page

Local Bankruptcy Rules for the United States Bankruptcy Court for the District of Massachusetts, Rule 4001-2(c)(4) ..... App. 89

Local Bankruptcy Rules for the United States Bankruptcy Court for the District of Delaware, Rule 4001-2(a)(i)(D) ..... App. 92

Local Bankruptcy Rules for the United States Bankruptcy Court for the Northern District of Illinois, Rule 4001-2(A)(2)(d) ..... App. 93

Local Bankruptcy Rules for the United States Bankruptcy Court for the Southern District of Ohio, Rule 4001-2(a)(1)(F) ..... App. 95

Local Bankruptcy Rules for the United States Bankruptcy Court for the Central District of California, Rule 4001-2 ..... App. 97

Letter Dated April 2, 1998 to the Delaware bankruptcy bar from Bankruptcy Judge Peter J. Walsh ..... App. 102

TABLE OF AUTHORITIES

Page

FEDERAL CASES

Chinery v. Official Committee of Unsecured Creditors of Cybergenics Corp., 124 S.Ct. 530 (U.S. Nov. 07, 2003) (No. 03-330) 13

Congress Credit Corp. v. AJC Intern., 186 B.R. 555 (D.P.R. 1995) 10

Ehrlich v. American Express Travel Related Services Co., Inc., 202 B.R. 9 (Bankr. N.D. N.Y. 1996) 15

In the Matter of Qualitech Steel Corp., 276 F.3d 245 (7th Cir. 2001) 5

In re Fonda Group, 108 B.R. 962 (Bankr. D. N.J. 1989) 15

In re Gibson Group, Inc., 66 F.3d 1436 (C.A.6 1995) 12

In re Huntsville Small Engines, Inc., 228 B.R. 9 (Bankr. N.D. Ala. 1998) 10

In re Metal Brokers Int'l, Inc., 225 B.R. 920 (Bankr. E.D. Wis. 1998) 10

In re North Atlantic Millwork Corp., 155 B.R. 271 (Bankr. D. Mass. 1993) 10

In re Xonics Photochemical, Inc., 841 F.2d 198 (C.A.7 1988) 12

Lincolnshire Management, Inc. v. Official Committee of Unsecured Creditors of Cybergenics Corp., 124 S.Ct. 530 (U.S. Nov. 06, 2003) (No. 03-327, R46-002) 13

Mellon Bank, N.A. v. Dick Corp., 351 F.3d 290 (7th Cir. 2003) 1, 7, 14, 17, 18

TABLE OF AUTHORITIES – Continued

Page

Hartford Underwriters Inc. Co. v. Union Planters Bank, N.A., 530 U.S. 1 (2000) ..... *passim*

Union Bank v. Wolas, 502 U.S. 151 (1991) 8

United States v. Ron Pair Enterprises, Inc., 489 U.S. 235 (1989) 8

STATE CASE

Colonial Sec. Corp. v. Allen, 1983 Del.Ch. LEXIS 393 (Del.Ch. April 18, 1983) 13

STATUTES

11 U.S.C. §101, *et seq.* 2

11 U.S.C. §363 ..... 5, 16

11 U.S.C. §364 16

11 U.S.C. §506 ..... 10, 11

11 U.S.C. §547 ..... 2, 4, 12, 14

11 U.S.C. §550 ..... 2, 6, 7, 9, 10

28 U.S.C. §151 1

28 U.S.C. §158 1

28 U.S.C. §1254(1) 2

28 U.S.C. §1334(b) 1

28 U.S.C. §2101(c) 2

TABLE OF AUTHORITIES – Continued

Page

RULES OF THE SUPREME COURT OF THE UNITED STATES

Rule 10 1

Rule 13 2

Rule 46.1 14

LEGISLATIVE HISTORY

H.R.Rep. No. 595, 95th Cong. 1st sess. 177-78 (1977), U.S.Code Cong. & Admin.News, 1978, pp. 5787, 6138 15

OTHER SOURCES

Crocker, *On the Edge*, 23-FEB Am. Bankr.Inst. J. 28 (2004) 7

King, *Collier on Bankruptcy*, ¶552.02[5][d][i] (15th ed. 2003) 15

Lander & Coburn, *A Snapshot of Recent Avoidance Cases*, 2004 No. 2 Norton Bankr.L. Adviser 2 (2004) 7

Local Bankruptcy Rules for the United States Bankruptcy Court for the Central District of California, Rule 4001-2 16

Local Bankruptcy Rules for the United States Bankruptcy Court for the District of Delaware, Rule 4001-2(a)(i)(D) 16

Local Bankruptcy Rules for the United States Bankruptcy Court for the Northern District of Illinois, Rule 4001-2(A)(2)(d) 16

TABLE OF AUTHORITIES – Continued

Page

Local Bankruptcy Rules for the United States Bankruptcy Court for the District of Massachusetts, Rule 4001-2(c)(4) 16

Local Bankruptcy Rules for the United States Bankruptcy Court for the Southern District of Ohio, Rule 4001-2(a)(1)(F) 17

Letter Dated April 2, 1998 to the Delaware bankruptcy bar from Bankruptcy Judge Peter J. Walsh 16

Schecter, *Preference Claims Assigned to Lenders Were "For the Benefit of the Estate" Even Though Preference Recoveries Did Not Follow to Estate [Mellon Bank vs. Dick Corp. (7th Cir.)]*, 2003 Comm.Fin. News. 104 (2003) 7

PETITION FOR WRIT OF CERTIORARI

Dick Corporation and GE Supply Company petition for a writ of certiorari to review the judgment and Opinion of the United States Court of Appeals for the Seventh Circuit entered on December 4, 2003 pursuant to Rule 10(c) of the Rules of the Supreme Court of the United States.

CITATIONS OF REPORTS OF OPINIONS ENTERED IN THE CASE

The opinion of the United States Court of Appeals for the Seventh Circuit is reported at *Mellon Bank, N.A. v. Dick Corp.*, 351 F.3d 290 (7th Cir. 2003), and appears in the Appendix hereto at App. 1. The opinion of the United States District Court for the Southern District of Indiana is reported at 2003 U.S. Dist. LEXIS 9427 (S.D. Ind. May 9, 2003), and appears in the Appendix hereto at App. 9. The opinion of the United States Bankruptcy Court for the Southern District of Indiana, Indianapolis Division is not reported but appears in the Appendix hereto at App. 57.

BASIS FOR SUPREME COURT JURISDICTION

The Bankruptcy Court had jurisdiction over the adversary proceeding in this bankruptcy case pursuant to 28 U.S.C. §1334(b) and 28 U.S.C. §151. The District Court had jurisdiction over the appeal from the Bankruptcy Court pursuant to 28 U.S.C. §158(a). The Seventh Circuit Court of Appeals had jurisdiction over the appeal from the final order of the District Court pursuant to 28 U.S.C. §158(d). This Court has jurisdiction over this Petition for

Writ of Certiorari pursuant to 28 U.S.C. §1254(1). The present petition is timely filed under 28 U.S.C. §2101(c) and under Rule 13.1 of this Court.

STATUTES INVOLVED

This case involves various sections of the United States Bankruptcy Code, 11 U.S.C. §101 *et seq.* The specific issues raised involve Section 550(a) of the Code, which provides:

> **§550. Liability of transferee of avoided transfer**
>
> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from –
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee.

Also involved is Section 547(b) of the Code, which provides:

> **§547. Preferences.**
>
> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made –

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if –

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

STATEMENT OF THE CASE

On or about June 20, 1996, Qualitech Steel Corporation ("Qualitech") entered into a contract with Petitioner Dick Corporation ("Dick Corp.") pursuant to which Dick Corp. became the general contractor for the construction of a state-of-the-art mini steel mill in Pittsboro, Indiana. App. 11. Petitioner GE Supply Company ("GE") sold gas

turbine engines to Qualitech, which were used at Qualitech's mill, as well as service and parts for those engines, between January 26, 1999 and March 10, 1999. *Id.*

On March 22, 1999, Qualitech and its parent company, Qualitech Steel Holding Corp. (collectively "the Debtors"), filed for Chapter 11 bankruptcy in the United States Bankruptcy Court for the Southern District of Indiana. *Id.* The bankruptcy was not filed for rehabilitative purposes, but rather to facilitate the sale of Qualitech's assets. *Id.* After the filing, Qualitech operated as a debtor-in-possession pursuant to Section 1107 of the Bankruptcy Code. App. 58, ¶1. At the time of the bankruptcy filing, Qualitech owed Dick Corp. in excess of $7 million. It owed GE in excess of $1.5 million. App. 11.

In or about May 1999, the Bankruptcy Court entered an Order approving the Debtors' financing arrangement with their Prepetition Senior Lenders, which included Respondent Mellon Bank, N.A. ("Mellon"), one of the Prepetition Lenders and the group's collateral agent. App. 13. The purpose of the DIP financing was to allow Qualitech to continue operating so that it could be sold as a going concern rather than holding a liquidation sale of its assets, all for the benefit of these secured creditors. App. 52, 59, ¶ 2. Under the arrangement, the Prepetition Lenders were afforded a lien on certain prepetition and postpetition assets of the Debtors. App. 13. Included in the collateral conveyed to the Prepetition Lenders in the financing arrangement were the Debtors' postpetition avoidance actions, including preference recovery actions under Section 547 of the Bankruptcy Code, 11 U.S.C. §547. App. 13-14.

In June 1999, the Debtors conducted an auction, at which Mellon, on behalf of the Prepetition Lenders, credit bid $180,000,000 of its lien and purchased substantially all of the Debtors' assets. App. 15. On August 13, 1999, the Bankruptcy Court entered an Order approving the sale pursuant to Sections 363 and 365 of the Bankruptcy Code. App. 15.

On November 3, 1999, the Official Committee of Unsecured Creditors of Qualitech Steel Corporation ("the Committee") filed a motion seeking leave to bring preference avoidance actions on behalf of the Debtors. App. 16. Mellon opposed the motion, stating that the proceeds of such avoidance actions were assets that belonged to the Prepetition Lenders. App. 17. The bankruptcy court denied the Committee's motion, which was upheld by the Seventh Circuit on appeal. *See In the Matter of Qualitech Steel Corp.*, 276 F.3d 245 (7th Cir. 2001). App. 17-18.

Following the Debtors' decision not to pursue any avoidance actions because there would be no benefit to the estate, the Prepetition Secured Lenders and the Debtors entered into a stipulation proposing to assign the Debtors' avoidance actions to the Prepetition Lenders. App. 18-22. The Court approved the stipulation on June 5, 2000. App. 18. Pursuant to this stipulation, the Prepetition Secured Lenders were entitled to the expenses of litigation plus the first $30 million recovered in any avoidance actions. App. 20-21. It is undisputed that $30 million will not be collected in the avoidance actions which Mellon seeks to prosecute. App. 39.

On June 29, 2000, Mellon commenced five preference avoidance actions in the Bankruptcy Court seeking total recoveries of approximately $1.8 million. App. 66, ¶22.

Among the five actions was one against Dick Corp. seeking recovery of alleged preferential transfers of $550,000 and another against GE seeking $344,349.65. *Id.* Once the various preference actions are complete, it is Qualitech's intention to have the bankruptcy case dismissed. App. 36, 39. No plan of reorganization will be filed or confirmed in this case. App. 52.

The parties filed cross-motions for summary judgment. On August 6, 2001, the Bankruptcy Court granted the summary judgment motions of Dick Corp. and GE and denied Mellon's motion. App. 55. In its opinion, the Bankruptcy Court held that it lacked subject matter jurisdiction because the avoidance actions had been transferred out of the estate. The Court alternatively held that because the actions were being brought solely for the benefit of the secured creditors, they were not brought "for the benefit of the estate," as required by Section 550 of the Code.

Mellon appealed to the District Court, which reversed the Bankruptcy Court's conclusion that it lacked subject matter jurisdiction but affirmed the Bankruptcy Court's holding that Mellon lacked standing to bring the avoidance actions.

Mellon appealed the District Court's decision to the Seventh Circuit, which reversed the District Court in an Opinion dated December 4, 2003.

REASONS FOR GRANTING THE WRIT

In a highly publicized opinion, the Court of Appeals for the Seventh Circuit dramatically changed the fundamental economics of the bankruptcy process. In its Opinion of

December 4, 2003, the Seventh Circuit held that a Chapter 11 debtor-in-possession may assign to a *secured creditor* the *debtor's statutory right* to recover a preferential transfer and that the secured creditor may also then recover the transfer *for the exclusive benefit of the secured creditor*.

The Seventh Circuit's holding is in conflict with the plain language of Section 550(a) of the Bankruptcy Code, which states that "*the trustee*" (which includes a Chapter 11 debtor-in-possession) "may *recover, for the benefit of the estate*, the property transferred" under Section 547.

Not surprisingly, in the few weeks since its publication, the Court's opinion has been the subject of numerous bankruptcy articles that elaborate on its impact. *See, e.g.*, Dan Schecter, *Preference Claims Assigned to Lenders Were "For the Benefit of the Estate" Even Though Preference Recoveries Did Not Follow to Estate [Mellon Bank vs. Dick Corp. (7th Cir.)]*, 2003 Comm.Fin. News. 104 (2003) (observing that *Mellon Bank* "sets precedent throughout the federal court system" and stands for the broad proposition that the benefit to the estate can occur at any time); Randall D. Crocker, *On the Edge*, 23-FEB Am. Bankr.Inst. J. 28 (2004) (questioning *Mellon Bank's* reliance on *Hartford Underwriters Inc. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000) – explaining that "the [Supreme] court [in *Hartford Underwriters*] did not endorse the estate's power to assign its statutory claims and noting that, post-*Mellon Bank*, the entire recovery for the benefit of a secured creditor is now acceptable"); David Lander & Thompson Coburn, *A Snapshot of Recent Avoidance Cases*, 2004 No. 2 Norton Bankr.L. Adviser 2 (2004) (discussing *Mellon Bank* and noting that post-*Mellon Bank*, the concept of benefit to the estate is now unbounded).

This Court should grant certiorari to address this important issue of federal bankruptcy law, which has national impact on the rights of creditors.

I. This Court Should Grant The Writ Because The Seventh Circuit's Opinion Permitting A Secured Creditor To Recover A Preferential Transfer For Its Own Benefit Is Contrary To The Plain Language Of Section 550 Of The Bankruptcy Code And Has Widespread National Implications.

When Congress enacted the Bankruptcy Code in 1978, it established a complex statutory scheme designed to protect and balance the interests of debtors and creditors. The avoidance provisions in the Code, which enable a trustee or debtor-in-possession to recover certain transfers "for the benefit of the estate" are an important part of the overall statutory scheme as they provide tools for promoting fairness in the distribution of the debtor's assets.

In the twenty-five years since its enactment, the Bankruptcy Code has been the subject of numerous opinions by this Court. In its opinions, this Court has consistently ruled that the lower courts must enforce the Bankruptcy Code according to its precise terms. *See, e.g., Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000); *Union Bank v. Wolas*, 502 U.S. 151, 158 (1991); *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989). In this instance, the Seventh Circuit went beyond the plain language of the Bankruptcy Code when it reversed the decisions of the bankruptcy court and the district court and permitted the secured creditor to maintain a cause of action that, if

successful, would result in a recovery for the secured creditor and not the estate.

Section 550 of the Code provides:

> **§550. Liability of transferee of avoided transfer**
>
> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, *the trustee may recover, for the benefit of the estate, the property transferred,* or, if the court so orders, the value of such property, from –
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee.

11 U.S.C. §550(a) (emphasis added).

In this case, the Section 547 preference actions commenced by Mellon, a secured creditor, sought to recover $550,000 from Dick Corp. and $344,349.65 from GE, unsecured creditors of Qualitech, and redirect those funds to Mellon, a secured creditor. The funds recovered would therefore not be "*for the benefit of the estate*," as required by Section 550, but would be for the benefit of a *secured creditor* – Mellon. The plain language of the Bankruptcy Code simply does not allow such a result.

As this Court recognized in *Hartford Underwriters*, "Congress says in a statute what it means and means in a statute what it says there." 530 U.S. at 6. Where, as here, "the statute's language is plain, the sole function of the court – at least where the disposition required by the text

is not absurd – is to enforce it according to its terms." *Id.* (quotations omitted). Accordingly, in *Hartford Underwriters*, this Court held that Section 506(c), which confers on "the trustee" the right to surcharge property that secures a claim, permitted recovery by the trustee or debtor-in-possession but not by any other party. *Id.*

Hartford Underwriters acknowledged but specifically declined to address the issue of whether a bankruptcy court can allow other interested parties to act in the trustee's stead in pursuing a recovery under Section 506(c). 530 U.S. at 13 n.5. The related issue here – whether a secured creditor can act in the trustee's stead to pursue a preference recovery under Section 550 – has not been addressed by this Court.

Bankruptcy courts construing Section 550 have held that the statute's use of the phrase "for the benefit of the estate" is not satisfied when the recovery benefits only a secured creditor. *See, e.g., In re Huntsville Small Engines, Inc.*, 228 B.R. 9, 13 (Bankr. N.D. Ala. 1998) ("where recovery will benefit an entity other than the estate, Section 550's requirement that recovery be for the benefit of the estate is not satisfied"); *In re North Atlantic Millwork Corp.*, 155 B.R. 271 (Bankr. D. Mass. 1993) (dismissing preference actions brought by secured creditors where proceeds of recovery would go directly to secured creditors); *Congress Credit Corp. v. AJC Intern.*, 186 B.R. 555 (D.P.R. 1995) (where party asserting avoidance had a lien on proceeds of recovery, there was no benefit to estate and party lacked standing); *accord In re Metal Brokers Int'l, Inc.*, 225 B.R. 920 (Bankr. E.D. Wis. 1998).

Moreover, the pledging of the preference causes of action by Qualitech to Mellon did not constitute a "recover[y], for

the benefit of the estate, [of] the property transferred" by the trustee. The plain reading of this statute contemplates that the actual recovery of the claim will benefit the estate. This recovery of the proceeds of a cause of action cannot occur until the cause of action has been commenced. Thus, the pledge of the proceeds of a yet to be commenced cause of action as part of an agreement regarding adequate protection for post-petition financing cannot constitute a "recover[y], for the benefit of the estate, [of] the property transferred" by the trustee.

This Court should grant the writ to resolve the conflict between the Seventh Circuit and the decisions of bankruptcy courts nationwide.

II. This Court Should Grant The Writ Because The Seventh Circuit's Opinion Permitting Mellon To Pursue A Preference Action Is Either Contrary To This Court's Decision In *Hartford Underwriters* Or Presumes The Answer To The Question Reserved In *Hartford Underwriters*.

In *Hartford Underwriters*, 530 U.S. 1, this Court, applying its rule of plain construction of Federal statutes, held that a creditor insurance company could not utilize Bankruptcy Code Section 506(c) to surcharge the collateral of a secured creditor for a benefit that the insurance company provided to the secured creditor. In so ruling, this Court relied on the plain language of the statute, which provides that "the trustee may recover," to conclude that a third party did not have standing to recover for its own benefit.

In footnote five of *Hartford Underwriters*, the Court specifically stated that it was not deciding whether a

bankruptcy court may permit creditors and creditors' committees to bring derivative actions in the trustee or debtor's stead:

> *We do not address whether a bankruptcy court can allow other interested parties to act in the trustee's stead in pursuing recovery under §506(c). Amici American Insurance Association and National Union Fire Insurance Co. draw our attention to the practice of some courts of allowing creditors or creditors' committees a derivative right to bring avoidance actions when the trustee refuses to do so, even though the applicable Code provisions, see 11 U.S.C. §§544, 545, 547(b), 548(a), 549(a), mention only the trustee.* See, *e.g.*, *In re Gibson Group, Inc.*, 66 F.3d 1436, 1438 (C.A.6 1995). Whatever the validity of that practice, it has no analogous application here, since petitioner did not ask the trustee to pursue payment under §506(c) and did not seek permission from the Bankruptcy Court to take such action in the trustee's stead. Petitioner asserted an independent right to use §506(c), which is what we reject today. Cf. *In re Xonics Photochemical, Inc.*, 841 F.2d 198, 202-203 (C.A.7 1988) (holding that creditor had no right to bring avoidance action independently, but noting that it might have been able to seek to bring derivative suit).

Hartford Underwriters, 530 U.S. at 13 n.5 (emphasis added).

This Court should consider this case in the context of *Hartford Underwriters*. Like the statute at issue in *Hartford Underwriters*, the preference statute, Section 547 of the Bankruptcy Code provides, that "the trustee may" take the required action. 11 U.S.C. §547(b). If Mellon's assertion of the preference case was for its own benefit, and the

action was therefore in its own right, this Court should accept certiorari, as the Seventh Circuit's holding would conflict with *Hartford Underwriters,* which holds that when a trustee is identified in the statute as the party with standing to bring an action, a third party creditor is not permitted to act.[1] *See also Colonial Sec. Corp. v. Allen*, 1983 Del.Ch. LEXIS 393,*8 (Del.Ch. April 18, 1983) (in a derivative action, the benefit of the recovery runs to the corporation rather than to the plaintiff individually).

Alternatively, to the extent Mellon is seen as acting derivatively, the issue before this Court is precisely the issue that was left unanswered in footnote 5 of *Hartford Underwriters*. It is an issue which continues to work its way to this Court, most recently in connection with the petitions for a writ of certiorari recently filed in the *Cybergenics* cases. [Nos. 03-327 and 03-330]. And as evidenced by the multiple amici briefs filed in the *Cybergenics* cases, the issue is clearly of national importance. The *Cybergenics* cases, like most bankruptcy preference cases, settled before the Court ruled on the petition. *Lincolnshire Management, Inc. v. Official Committee of Unsecured Creditors of Cybergenics Corp.*, 124 S.Ct. 530 (U.S. Nov. 06, 2003) (No. 03-327, R46-002); *Chinery v. Official Committee of*

[1] The Code provides for two other individuals or entities that may bring a preference case. Pursuant to Section 1107 of the Bankruptcy Code, a Chapter 11 debtor in possession (here Qualitech) may perform the function of a trustee. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, n.3 (1983). Alternatively, pursuant to Section 1123(b)(3)(B), a representative of the Chapter 11 estate appointed for the purpose of pursuing claims under a confirmed plan may bring such an action. *In re DeLaurentiis Entertainment Group*, 87 F.3d 1061 (10th Cir. 1996). Because there will not be a plan in the *Qualitech* case, Mellon does not qualify as a Section 1123 representative.

Unsecured Creditors of Cybergenics Corp., 124 S.Ct. 530 (U.S. Nov. 07, 2003) (No. 03-330) (dismissing pursuant to Rule 46.1). Thus, the *Mellon Bank* decision affords this Court the opportunity to provide clear guidance on the issue and answer that which was left unanswered in *Hartford Underwriters*.

III. This Court Should Grant The Writ Because The Seventh Circuit's Decision Will Impact The Fundamental Economics Of The Bankruptcy Process To The Detriment Of Unsecured Creditors.

Congress, through the Bankruptcy Court, has designed a system that provides a mechanism by which a debtor can sort out its financial affairs under the auspices of the Federal Court system. The bankruptcy system provides, among other things, a mechanism whereby a trustee or debtor-in-possession can attempt to pull back into the bankruptcy estate certain payments made during the ninety days prior to the filing of the bankruptcy case. This statute, the preference statute, provides the means by which the trustee can recover funds and provide for a more even distribution to creditors. As the legislative history of Section 547 explains:

> [M]ore important[ly], the preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. *Any creditor that received a greater payment than others of his class is required to disgorge so that all may share equally*. The operation of the preference section to deter 'the race of diligence' of creditors to dismember the debtor before bankruptcy furthers the second goal of the preference section – that of equality of distribution.

H.R.Rep. No. 595, 95th Cong. 1st sess. 177-78 (1977), U.S.Code Cong. & Admin.News, 1978, pp. 5787, 6138. (emphasis added)[2]

The right to bring a preference action is an inchoate right that does not exist until the debtor files for bankruptcy. *Ehrlich v. American Express Travel Related Services Co., Inc.*, 202 B.R. 9, 12 (Bankr. N.D. N.Y. 1996) (preference actions "arise under" the Bankruptcy Code); *In re Fonda Group*, 108 B.R. 962, 966 (Bankr. D. N.J. 1989) (preference cause of action is created on date petition is filed). Because the cause of action does not exist prepetition, it is not an asset to which a prepetition secured creditor's lien could attach. L. King, 5 *Collier on Bankruptcy*, ¶552.02[5][d][i] at p. 552.04-16 (15th ed. 2003) (monies recovered as a result of a preference action are generally not considered "proceeds" because such actions can generally only be pursued by trustee). The preference recoveries, therefore, are typically available for distribution to all unsecured creditors in the case. In many bankruptcy cases, the recoveries of preference and other

[2] The federal courts have universally acknowledged the dual purposes of equality of distribution and preventing the economic dismantling of the debtor. *In re Jones Truck Lines, Inc.*, 130 F.3d 323, 326 (8th Cir. 1997) (stating that section 547 "is intended to discourage creditors from racing to dismember a debtor sliding into bankruptcy and to promote equality of distribution to creditors in bankruptcy."); *In re Ogden*, 314 F.3d 1190, 1196 (10th Cir. 2002) (reiterating dual purpose of preference statute). Thus, to promote equality of distribution, the "focus is not on the size of the debtor's estate; rather its essential function is to move the determination date of the estate backwards in time to effect a *redistribution* among creditors." *Carrozzella & Richardson v. Parete*, 270 B.R. 92, 99 (Bankr. D. Conn. 2001) (emphasis in original).

avoidance actions are the only funds available for distribution to unsecured creditors because the debtor's other assets are highly leveraged and all subject to the secured creditors' liens.

In a bankruptcy case, in order for a creditor to obtain a lien on preference actions, it must obtain prior court approval of the transaction that will give the creditor the lien. 11 U.S.C. §§363, 364. Such a lien typically arises in connection with a cash collateral or funding order entered in the first few days of the case. In that instance, the lender obtains such a lien in exchange for allowing the debtor to continue to utilize cash to operate.

Because causes of action on preference claims are often the only source of potential recovery for unsecured creditors, Bankruptcy Courts are understandably reluctant to grant such liens to secured creditors. In his 1998 letter to the Delaware bankruptcy bar, Bankruptcy Judge Peter J. Walsh of the District of Delaware made clear that in initial filings regarding cash collateral, "[a]bsent exigent circumstances, neither the loan documents nor the order should give the lender a lien position on avoidance actions." App. 106, ¶7. Indeed, many of the bankruptcy courts which have significant Chapter 11 caseloads require, by local rule, that proposed cash collateral orders, which provide for the granting of such liens, be highlighted. *See, e.g.*, Local Bankruptcy Rules for the United States Bankruptcy Court for the Central District of California, Rule 4001-2; App. 97; Local Bankruptcy Rules for the United States Bankruptcy Court for the District of Delaware, Rule 4001-2(a)(i)(D); App. 95; Local Bankruptcy Rules for the United States Bankruptcy Court for the Northern District of Illinois, Rule 4001-2(A)(2)(d); App. 93; Local Bankruptcy Rules for the United States Bankruptcy Court for the District of Massachusetts, Rule 4001-2(c)(4); App. 90;

Local Bankruptcy Rules for the United States Bankruptcy Court for the Southern District of Ohio, Rule 4001-2(a)(1)(F). App. 95.

The rationale for the Bankruptcy Court's reluctance to grant these liens on preference actions is simple. A debtor which files for Chapter 11 bankruptcy is desperate to keep operating. To operate, it must have the use of cash, and it typically seeks the permission from and cooperation with its current lender to use cash collateral that is otherwise subject to that lender's lien. The lender, who already has tremendous leverage at this point in a bankruptcy case, can, absent some prohibition, insist on a lien on the avoidance actions. And because the debtor is desperate to operate and being asked to give up the rights of unsecured creditors in exchange for the lender's agreement to allow the debtor to operate, the debtor is willing to grant the lien. Thus, the ability of unsecured creditors to recover in these cases is foreclosed at a point in time when the bankruptcy case is a few days old and no one has had a meaningful opportunity to review the debtor's books and records to determine if any significant preference claims exist.[3]

In this very typical scenario, the impact of *Mellon Bank* is enormous. The "level playing field" that Congress intended when it enacted the Bankruptcy Code may have now become even more uneven. The secured creditor – a party that already enjoys tremendous leverage – is now armed with a reported decision from a respected Court of

[3] Such a review could determine, for example, that the unsecured creditors stand to gain nothing in a sale or reorganization context, other than the proceeds of the preference actions. Thus, it would not be in their interests to permit them to be pledged.

Appeals panel saying that this arrangement is not only acceptable, but it also constitutes sufficient benefit to the estate such that the unsecured creditors must contribute to the secured creditor's recovery. This holding is a significant departure from Congress' intent of equality of treatment among similarly situated creditors. The *Mellon Bank* decision has encouraged a new currency with which the debtor and secured creditor can deal to the detriment of unsecured creditors. This Court should grant petitioners' writ of certiorari to decide these important questions of federal bankruptcy law.

CONCLUSION

A writ of certiorari should issue to review the important national issues raised by the Opinion of the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

LAWRENCE G. MCMICHAEL
Counsel of Record
MARTIN J. WEIS
VIRGINIA H. MCMICHAEL
DILWORTH PAXSON LLP
3200 Mellon Bank Center
1735 Market Street
Philadelphia, PA 19103

CHARLEYNE L. GABRIEL
KUNZ & OPPERMAN, P.C.
1750 First Indiana Plaza
135 North Pennsylvania Street
Indianapolis, IN 46204

Attorneys for Petitioners

In the
United States Court of Appeals
for the Seventh Circuit

No. 03-2604

MELLON BANK, N.A., as agent for 14 prepetition senior lenders of Qualitech Steel Corp.,

Plaintiff-Appellant

v.

DICK CORPORATION and GE SUPPLY COMPANY,

Defendants-Appellees.

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division.
No. IP 02-0040-C-M/S – **Larry J. McKinney, *Chief Judge*.**

SUBMITTED OCTOBER 20, 2003[1] –
DECIDED DECEMBER 4, 2003

Before BAUER, POSNER, and EASTERBROOK, *Circuit Judges*.

EASTERBROOK, *Circuit Judge*. Bankruptcy law entitles debtors' estates to recover preferential transfers, including payments on account of antecedent debts made during the 90 days before the commencement of the proceeding. 11

---

[1] This appeal is successive to *In re Qualitech Steel Corp.*, 276 F.3d 245 (7th Cir. 2001), and has been submitted to the original panel under Operating Procedure 6(b). The panel has decided that further oral argument is unnecessary.

U.S.C. § 547(b). Preferences are recovered "for the benefit of the estate" (11 U.S.C. § 550(a)) and thus profit all creditors according to their statutory and contractual entitlements. We must decide whether the right to recover a preference is an asset of the estate that may be assigned or distributed to a particular class of creditors to satisfy their entitlements. A different way to put the same question is whether a suit on behalf of all creditors in the money is "for the benefit of the estate". Either way the issue is characterized, our answer is "yes."

The dispute arises from a complex series of transactions that can be summed up simply. When Qualitech Steel entered bankruptcy, it was in economic distress – that is to say, it had a negative operating cash flow. (Financial distress, by contrast, entails a positive cash flow that is not large enough to retire existing debts.) Qualitech's equity was worthless. Secured debts exceeded the value of its assets. Most creditors, both secured and unsecured, agreed that the best step was to sell Qualitech promptly as a going concern to someone willing to take the risk of trying to turn the business around. In order to finance its operations for the time necessary to effect a sale – Qualitech was burning through cash at a monthly rate of $10 million – a syndicate of lenders advanced some additional capital. In order to mollify the prepetition secured creditors that did not want to participate, the bankruptcy judge promised them that, if their position deteriorated during the interim, they would be entitled to dibs on as much as $30 million of Qualitech's remaining assets, including the value of any preference-recovery actions. *In re Qualitech Steel Corp.*, 276 F.3d 245 (7th Cir. 2001), held over the protest of the unsecured creditors that this promise was within the bankruptcy judge's authority,

and that the judge also properly found that the secured creditors' position had in fact deteriorated, entitling them to the first $30 million of any preference-recovery actions.

The sale price was insufficient to cover both the new super-priority loans and the original secured loans. The original secured lenders' unsatisfied debts exceeded the value of any anticipated preference recoveries. Because at this point the estate was penniless, a committee of the secured lenders advanced funds to finance preference actions through Mellon Bank, which was appointed as the creditors' agent to collect on behalf of the (dissolved) debtor in possession, Qualitech. Multiple preference-recovery actions have been filed; recoveries to date exceed $10 million. But Dick Corp. and GE Supply Co. contended that they need not return the roughly $1 million in last-minute payments they received. They advanced two principal arguments: first that the entitlement to pursue avoidance actions had been sold with Qualitech's business, and second that recoveries that would flow straight to the pockets of secured creditors are not "for the benefit of the estate" as § 550(a) uses that phrase. The bankruptcy judge agreed with both lines of argument and dismissed the actions. On an appeal under 28 U.S.C. § 158(a), the district judge rejected the first contention but accepted the second, and thus affirmed the judgment. 2003 U.S. Dist. LEXIS 9427 (S.D. Ind. May 9, 2003). We have jurisdiction of the creditors' appeal, because the order under review is the final decision in an adversary proceeding. 28 U.S.C. § 158(d).

Dick and GE (collectively the "preference recipients") ask us to affirm on the theory that the buyer of Qualitech's assets, rather than the secured creditors, owns any entitlement to recover preferential transfers. Although the

district judge disagreed with this contention, and the preference recipients did not file a cross-appeal, litigants may offer on appeal any properly preserved argument that supports the judgment. See *Massachusetts Mutual Insurance Co. v. Ludwig,* 426 U.S. 479 (1976). It is enough to say, however, that we agree with the district judge's treatment of this issue, for the reasons the judge gave.

Another potential show-stopper also requires little discussion. According to 11 U.S.C. § 547(b), a trustee or a debtor in possession may prosecute a preference-recovery action, and Mellon Bank is neither. See also *Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A.,* 530 U.S. 1 (2000) (enforcing similar limitation in 11 U.S.C. § 506(c)). But Mellon Bank has stepped into the shoes of the dissolved Qualitech, acquiring the debtor's claim by means of the order we affirmed in *Qualitech Steel.* The Supreme Court's decision in *Hartford Underwriters* did not disturb decisions allowing a lineal descent of statutory rights. 530 U.S. at 13 n.5. Thus we need not determine whether creditors ever may pursue avoidance actions while a debtor in possession or trustee exists, and over their opposition, by a rationale along the lines of shareholders' derivative actions in corporate law. See *In re Xonics Photochemical, Inc.,* 841 F.2d 198, 203 (7th Cir. 1988). Cf. *Unsecured Creditors of Cybergenics Corp. v. Chinery,* 330 F.3d 548 (3d Cir. 2003) (en banc).

Thus we arrive at the question whether a recovery for the use of secured creditors can be "for the benefit of the estate". We say "can be" rather than "is" because, by the time Mellon Bank filed the first preference-recovery action, there was no "estate"; Qualitech is gone and its assets are in new hands. But an *ex post* inquiry misses the real benefit. The potential to recover funds from preference recipients

was put to use for the estate's benefit – at a time when Qualitech still existed and had unsecured creditors – when the bankruptcy court promised this value to the objecting secured lenders to compensate them for risk while new super-secured funds were raised and the assets were sold. Instead of calling off the sale, or distributing some assets to the secured creditors, or taking some other step that (the bankruptcy judge believed at the time) would have made creditors as a whole worse off, the judge used the value of these assets to protect the secured creditors' position and thus facilitate what appeared to be the most productive course of action. Qualitech's assets were sold, and unsecured creditors received a bonus of $7.5 million. (The record does not reveal why the secured creditors agreed to this departure from absolute priority.)

Having put the *prospect* of preference recoveries to work for the benefit of all creditors (including the unsecured creditors) *ex ante* by effectively selling them to the secured creditors in exchange for forbearance – and in the process facilitating a swift sale that was beneficial all around – the bankruptcy judge did not need to use them *ex post* a second time, for still another benefit to the estate; there was no further benefit to be had. We established in *P.A. Bergner & Co. v. Bank One, Milwaukee, N.A.*, 140 F.3d 1111, 1118 (7th Cir. 1998), that § 550(a) is satisfied by an indirect benefit to the estate, and the point hardly seems arguable even as an original matter. (There are no decisions to the contrary, other than the one under review.) The estate's *ex ante* benefit is all that the statute requires. That much would be clear if the secured creditors had *purchased* for $30 million in cash (paid into Qualitech's estate before its assets were sold) the right to pursue the preference-recovery actions; it is no less clear when the

incoming cash takes the form of DIP financing that is secured in part by the promise that preference-recovery actions can be used to make good any losses the secured lenders otherwise must absorb.

Lest this way of resolving the issue be taken to assume that § 550(a) requires that some benefit flow to unsecured creditors, we add that the statute does not say this. Section 550(a) speaks of benefit to *the estate* – which in bankruptcy parlance denotes the set of all potentially interested parties – rather than to any particular class of creditors. What happens to recoveries that reach the estate's coffers depends on contractual and statutory entitlements. To see this, consider a business that is reorganized under judicial supervision rather than auctioned off. Suppose this firm has $10 million in cash (including receivables) plus assets that could be sold for $90 million, and $150 million in secured debt. The security interest includes a floating lien on inventory, cash on hand, and receivables. This firm belongs to the secured creditors; unsecured creditors are not legally entitled to a dime; any influx of cash will go to the benefit of secured lenders to reduce the deficiency. Yet no one doubts that this debtor in possession (or a trustee) could bring a preference-recovery action under § 547. The operating business counts as an "estate" without regard to the identity (and priority) of those who will receive distributions eventually. We cannot see any reason why a firm with the same financial attributes – that is, one in which both equity investors and unsecured creditors will be wiped out – can bring avoidance actions if the business is reorganized under the supervision of the senior lenders, but not if these lenders and the judge decide to sell the business as a going concern to a third party. Such a sale

does not injure preference recipients (or unsecured creditors), so there is no reason why it should entitle the preference recipients to keep the money.

A legal rule that the quick sale of a business precludes avoidance actions by eliminating any benefit to the estate would derail many beneficial sales (because selling the business would reduce its value by abandoning opportunities to recover last-minute payouts). Likewise it would encourage the managers to make preferential transfers to favored vendors (who would not need to repay the firm). Neither of these consequences would be desirable. Our prior opinion establishes that using the prospect of avoidance actions as additional collateral promoted an efficient disposition of Qualitech's business (or so, at least, the bankruptcy judge was entitled to conclude at the time the financing was secured). That would not have been possible if, as the preference recipients argue here, the transaction vaporized the collateral sought to be used. Our reading of the Bankruptcy Code avoids these problems and enables the judge and the creditors to choose between in-court reorganization and immediate sale by reference to their economic benefits rather than legal artifacts.

REVERSED AND REMANDED

A true Copy:

Teste:

_____

Clerk of the United States Court of Appeals for the Seventh Circuit

United States Court of Appeals

For the Seventh Circuit

Chicago, Illinois 60604

JUDGMENT – WITHOUT ORAL ARGUMENT

Date: December 4, 2003

BEFORE: Honorable WILLIAM J. BAUER, Circuit Judge

Honorable RICHARD A. POSNER, Circuit Judge

Honorable FRANK H. EASTERBROOK, Circuit Judge

No. 03-2604

IN RE: QUALITECH STEEL CORPORATION and QUALITECH STEEL HOLDINGS CORPORATION, Debtors

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division No. 02 C 40, Larry J. McKinney, Chief Judge

The judgment of the District Court is REVERSED and this appeal is REMANDED, with costs, in accordance with the decision of this court entered on this date.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

In re QUALITECH STEEL CORPORATION QUALITECH STEEL HOLDINGS,	) IP 02-0040-C-M/S) District Court) Cause No.
MELLON BANK, N.A. as Collateral Agent for the Prepetition Lenders on behalf of Qualitech Steel Corp., Plaintiff, vs. GE SUPPLY COMPANY, Defendant,	) Case No. 99-3364-AJM-11) Case No. 99-3363-AJM-11) Jointly Administered Under 99-3364-AJM-11) Adversary Proceeding No. 00-298
MELLON BANK, N.A. as Collateral Agent for the Prepetition Lenders on behalf of Qualitech Steel Corp., Plaintiff, vs. DICK CORPORATION, Defendant.	) Consolidated for Purposes of Appeal) Adversary Proceeding No. 00-296

ORDER

This cause is before the Court on an appeal from a decision of the Bankruptcy Court on cross-motions for summary judgment in the adversary proceedings brought by the adversary plaintiff, Mellon Bank, N.A. ("Mellon"), against two defendants, GE Supply Company ("GE") and

Dick Corporation ("DC") (collectively, the "Defendants"). The Bankruptcy Court granted summary judgment to GE and DC and denied summary judgment to Mellon. On appeal, Mellon asserts that the Bankruptcy Court erred when it found that it lacked jurisdiction over the proceedings because the assets at issue had been transferred out of the estate and because Mellon lacked standing. Mellon also avers that the Bankruptcy Court erred in denying its summary judgment motion on the merits. The Bankruptcy Court also denied Mellon's motion for reconsideration, which Mellon asserts as error.

For the reasons discussed herein, the Court REVERSES the decision of the Bankruptcy Court that finds a lack of subject matter jurisdiction and AFFIRMS the decision of the Bankruptcy Court that Mellon lacks standing to bring suit against the Defendants.

I. FACTUAL & PROCEDURAL BACKGROUND

Qualitech Steel Corporation ("Qualitech") was launched as a start-up project finance venture. Appellant's Exh. 2, at 2. It was intended that Qualitech be a state-of-the-art specialty producer of steel with facilities in Pittsboro, Indiana and Corpus Christi, Texas. *Id.* Qualitech was a wholly-owned subsidiary of Qualitech Steel Holdings Corp. ("Holdings") (collectively, Qualitech and Holdings, "Debtors"). *Id.*

To finance the operation, Qualitech borrowed in excess of $265,000,000.00 from a group of financiers (the "Prepetition Senior Lenders") in the form of both term and revolving loans. *Id.* These loans were secured by first priority liens upon and security interests in substantially all of Qualitech's assets. *Id.* at 3.

On or about June 20, 1996, DC contracted with Qualitech for the construction of a proposed state of the art special bar quality mini-mill in Pittsboro, Indiana. According to the complaint filed against DC, in or about February 1999, DC received payments in the approximate amount of $550,000.00 from Qualitech in accordance with contractual arrangements. Appellees' Exh. 1.

GE sold gas turbine engines to Qualitech; it also serviced and supplied parts for those engines. According to the complaint filed against GE, it received alleged preference payments from Qualitech for those services and supplies in the amount of $344,349.65 during the period from January 26, 1999, through March 10, 1999. Appellant's Exh. 14.

On March 22, 1999, Qualitech and Holdings filed for Chapter 11 relief in the United States Bankruptcy Court for the Southern District of Indiana. Appellees' Exh 1. The record reflects that the bankruptcy action was filed in an effort to facilitate the sale of the Debtors' assets. *See* Appellees' Exh. 3, Exh. C., ¶ 5; Appellant's Br. at 4. At the time of the filing of the bankruptcy case, Qualitech owed DC in excess of $7,000,000.00; Qualitech owed GE in excess of $1,500,000.00. Appellant's Exh. 23, ¶ 3. Qualitech also owed the Prepetition Senior Lenders a large portion of the funds it originally borrowed.

When the Debtors filed their petition, they sought a financing order that would permit them to borrow from a group of lenders (the "DIP Lenders") the funds necessary to sustain operations. The DIP Lenders agreed to the loan in exchange for obtaining a super-priority lien in accordance with § 364 of the Bankruptcy Code. Appellant's Exh.1, Interim Order (I) Authorizing the Debtors to

Obtain Postpetition Financing with Administrative Superpriority and Secured by Senior Liens on and Security Interest in the Assets of the Debtors Pursuant to 11 U.S.C. §§ 364(c)(1), (2), (3), & 364(d)(1) and to Utilize Cash Collateral Pursuant to 11 U.S.C. § 363(II) Granting Adequate Protection and (III) Scheduling a Final Hearing Pursuant to Bankruptcy Rule 4001, at 1 ("Interim Financing Order"). According to the Bankruptcy Court, because the Debtors had no unencumbered assets with which to secure new loans, and because of the Debtors' poor operational status and continuing losses, they were forced to obtain financing on a super-priority, priming lien basis. *Id.* at 8, ¶¶ K & L.

On March 23, 1999, the Bankruptcy Court entered an order approving interim post-petition financing (the "Interim Financing Order"). *See id.* Pursuant to the interim financing order, the new senior liens granted to the DIP Lenders and the ongoing use of the prepetition collateral effectively displaced and subordinated the Prepetition Senior Lenders' liens on the prepetition collateral. Under those circumstances, the Bankruptcy Court determined that the Prepetition Senior Lenders were entitled to adequate protection of their interests in the prepetition collateral. *Id.* at 9 (citing 11 U.S.C. §§ 361, 363(e), 364(d)(1)).

Specifically, in its Final Financing Order the Bankruptcy Court granted the Prepetition Senior Lenders "a replacement security interest in and lien upon all the Collateral, subject and subordinate only to the Senior Liens granted to the Banks pursuant to this Order and the Credit Agreement" ("replacement lien") and "a priority claim pursuant to section 507(b) of the Bankruptcy Code, subject and subordinate only to the Superpriority Claims

granted to the Banks," both of which were "limited in amount to the aggregate diminution in value following the Petition Date as a result of the utilization of Cash Collateral and the granting of Senior Liens." Appellant's Exh. 3, Final Order (I) Authorizing the Debtors to Obtain Postpetition Financing with Administrative Superpriority and Secured by Senior Liens on and Security Interests in the Assets of the Debtors Pursuant to 11 U.S.C. §§ 364(c)(1), (2), (3) & 364(d)(1) and to Utilize the Cash Collateral Pursuant to 11 U.S.C. § 363 and (II) Granting Adequate Protection, May 13, 1999, at 20 ("Final Financing Order"). The Bankruptcy Court later determined that the amount of diminution in value of the Collateral was an amount not less than $30 million. Appellant's Exh. 10, Order Determining the Extent of the Prepetition Senior Lenders [sic] Replacement Lien Pursuant to the Final Financing Order, at 4 ("Replacement Lien Order").

In the Final Financing Order, the Bankruptcy Court defined "Collateral" as

> all now existing or hereinafter acquired personal and real property of the Debtors or their estates, of any kind or nature whatsoever, and the products and proceeds thereof, including, without limitation, all real property, personal property, general intangibles, claims, equipment, accounts receivable and inventory of the Debtors (as more particularly described in the Credit Agreement).

Appellant's Exh. 3, Final Financing Order, at 2. The Credit Agreement specifically described "Avoidance Recovery Property and Avoidance Claims of each of the Borrower

and the Parent" as Collateral.[1] *Id.* Exh. A, First Amended Postpetition Credit and Guarantee Agreement, § 5.2(ix). These terms included avoidance actions of the Debtors pursuant to 11 U.S.C. §§ 547 and 550, and any proceeds therefrom. *Id.* § 1.1.

The Bankruptcy Court supported its rulings with the following findings:

> M. The Debtors are unable to obtain unsecured credit allowable under section 503(b)(1) of the Bankruptcy code as an administrative expense or pursuant to sections 364(a) or (b) of the Bankruptcy Code except on the terms and conditions set forth herein. Financing on a postpetition basis is not otherwise available to the Debtors without the Debtors (i) granting, pursuant to section 364(c)(1) of the Bankruptcy Code, claims having priority over any and all administrative expenses . . . , (ii) securing, pursuant to section 364(c) and 364(d) of the Bankruptcy Code, such indebtedness with perfected first priority senior security interests in and liens upon all of the Collateral, and (iii) providing adequate protection of the Prepetition Senior Lenders' and

[1] An "Avoidance Claim" was defined: "Any claim of either the Borrower or the Parent to avoid a transfer either of the Borrower or the Parent under the Bankruptcy Code, including, without limitation, any claim for avoidance arising under sections 542, 544, 546, 547, 548, 549, 550, 551 or 553 of the Bankruptcy Code or otherwise." Appellant's Exh. 3, Exh. A, First Amended Postpetition Credit and Guarantee Agreement, § 1.1. Correspondingly, "Avoidance Recovery Property" was defined: "Any property of either of the Borrower or the Parent that has been or could be recovered through the successful pursuit of an Avoidance Claim."

> Prepetition Subordinated Lenders' interests in the Collateral.
>
> N. Under the circumstances, no other source of financing exists, on terms more favorable than those offered by the Banks.

Id., Final Financing Order, at 9.

On June 30, 1999, the Debtors conducted an auction of their "assets." Appellant's Exh. 6, *In re: Qualitech Steel Corporation, Qualitech Steel Holdings Corp.*, Case No. 99-03364-AJM-11, Tr. of Auction Proceedings, June 30, 1999 ("Sale Tr."). At the auction, the "assets" were described by the auctioneer as "two facilities" and several leases and executory contracts associated with those two facilities. *Id.* at 5-8. The Prepetition Senior Lenders proffered a credit bid for both facilities in the amount of $180 million; which was determined to be the highest bid. *Id.* at 32-35.

On August 13, 1999, the Bankruptcy Court entered an order that approved the sale of substantially all of the assets of the Debtors (the "Sale Order"). Appellant's Exh. 7, Order Approving the Sale of Substantially all of the Debtors' Assets Free and Clear of all Liens, Claims, Encumbrances and Interests Pursuant to 11 U.S.C. § 363 and the Assumption and Assignments of Executory contracts and Unexpired Leases Pursuant to 11 U.S.C. § 365 ("Sale Order"). The Bankruptcy Court determined that the Prepetition Senior Lenders' credit bid was "the highest or otherwise best offer for the Assets, is reasonable and necessary and is in the best interests of the Debtors, their estates and their creditors." *Id.* at 4. The Bankruptcy Court defined "Assets" as

> all of the Debtors' rights, title and interests in and to the Collateral described by and contained

> in the Final Financing Order and the Prepetition Loan Documents together with such inventory, accounts receivable, materials ordered but not yet delivered to the Debtors, provided that with respect to the material ordered and not yet delivered to the Debtors, such materials have been or will be paid for. For the purposes of this Order such Collateral shall be referred to herein as the Assets.

Id. at 4 n.2. Subsequently, the sale occurred on August 25, 1999, where "substantially all of the Debtors' assets were sold . . . to the Prepetition Senior Lenders' designees, Qualitech Steel SBQ, LLC and Qualitech Steel Iron Carbide Corp," (collectively, the "Purchasers"). Appellant's Exh. 11, Stipulation and Order (A) Authorizing Prepetition Senior Lenders to Prosecute Avoidance Actions on Behalf of the Debtors and (B) Modifying the Automatic Stay to Permit Prepetition Senior Lenders to Apply Proceeds to Avoidance Actions, at 2 ("Avoidance Actions Order").

Several months later, on November 3, 1999, the Official Committee of Unsecured Creditors of Qualitech Steel Corporation (the "Committee") filed a motion seeking leave of the Bankruptcy Court to bring the Debtor's avoidance actions. Appellant's Exh. 8, Motion by the Official Committee of Unsecured Creditors: (A) To Determine Rights Under the Postpetition Financing Orders to Proceeds from Avoidance Actions; or in the Alternative, (B) to Convert These Cases to Cases Under Chapter 7, at 1 ("Committee's Motion"). The Committee's primary argument was that the value of the Debtors' Collateral had increased postpetition as a result of the postpetition financing arrangement and changes in the market for the Debtors' products. *Id.* at 4-5. Therefore, no lien could arise

in favor of the Prepetition Senior Lenders under the Final Financing Order. *Id.* at 5.

Mellon opposed the motion, arguing in part:

> Other than to observe that the Committee's lawyers have been unsuccessful in coercing the Senior Lenders into paying their fees above and beyond the negotiated "carve-out", one wonders why the Committee has insisted on engaging this dispute now, in advance of any showing that there are any preference recoveries to be pursued for the benefit of the estates. (Clearly, this would be necessary before the Court could authorize the expenditure of further fees by Committee counsel in pursuit of these recoveries. *See In re STN Enterprises,* 779 F.2d 901 (2d Cir. 1985). (The Committee has made no showing in this regard, otherwise leading one to conclude that its motion is not ripe for adjudication.)
>
> That being said, the Senior Lenders and the Debtors have undertaken such a preference analysis and recognize that there are recoveries to be pursued, albeit for the benefit of the Senior Lenders under their replacement and other liens.

Appellees' Exh. 4, Response of the Senior Lenders to Motion by Creditors' Committee to Determine Rights Under Financing Orders or to Convert the Cases to Cases Under Chapter 7, at 2 n.2.

However, on March 14, 2000, the Bankruptcy Court issued an order that denied the Committee's motion and ruled that there was a diminution in value of the Prepretition Senior Lenders' Collateral of not less than $30 million. Appellant's Exh. 10, Replacement Lien Order, at 4.

Specifically, the Bankruptcy Court made the following pertinent findings:

> 2. The aggregate diminution in the value of the Collateral of the Prepetition Senior Lenders from the Petition Date through the Sale Date as the result of the use of Cash Collateral and the granting of senior security interests and liens in the Collateral exceeds $30,000,000 and the Replacement Lien, the validity and priority of which hereby are reaffirmed without any derogation of its validity and priority arising under and by virtue of the Final Financing Order, which order in all respects shall remain unaffected by any provision of this Order, has attached to the assets of the Debtors comprising the Collateral, including the Avoidance Recovery Property, other than those assets transferred pursuant to the Sale Order.
>
> 3. As a result, the extent of the Replacement Lien granted to the Prepetition Senior Lenders pursuant to the Final Financing Order in all Collateral, including the Avoidance Recovery Property, be and hereby is fixed in an amount of not less than $30,000,000.

Id. The Committee appealed the Bankruptcy Court's order to both the United States District Court for the Southern District of Indiana and the Seventh Circuit. *See In re Qualitech Steel Corp.*, 276 F.3d 245 (7th Cir. 2001); *Official Comm. of Unsecured Creditors v. Bank Group,* No. IP00-0496-C-H/G, 2001 WL 899637 (S.D. Ind. July 5, 2001) (BA543062). Both courts affirmed the Bankruptcy Court's decision.

On or about June 5, 2000, the Bankruptcy Court approved a Stipulation and Order (A) Authorizing Pre-Petition

Senior Lenders to Prosecute Avoidance Actions on Behalf of the Debtors and (B) Modifying the Automatic Stay to Permit Pre-Petition Senior Lenders to Apply Proceeds of Avoidance Actions ("Authorization Stipulation") between Qualitech and Mellon. Appellant's Exh. 11, Authorization Stipulation. The Authorization Stipulation states the following relevant facts:

> WHEREAS, pursuant to that certain "Order Determining the Extent of the Prepetition Senior Lenders Replacement Lien [P]ursuant to the Final Financing Order," entered on March 14, 2000 (the "Replacement Lien Order"), this Court determined that (a) the aggregate diminution in value of the collateral of the Prepetition Senior Lenders from the Petition Date through the Sale Date as the result of the use of cash collateral and the granting to the Banks of senior security interests and liens in the collateral exceeds $30,000,000 and (b) as a result, the amount of the Replacement Lien granted to the Prepetition Senior Lenders pursuant to the Final Financing Order in all Collateral, including, without limitation, the Avoidance Claims and Avoidance Recovery Property, is not less than $30,000,000; and
>
> WHEREAS, as a result of the foregoing, the Prepetition Senior Lenders have senior liens upon and security interests in the Collateral, including, without limitation, all Avoidance Claims and Avoidance Recovery Property; and
>
> WHEREAS, the Debtors have analyzed the Avoidance Claims and determined that there is no equity in the Avoidance Claims for the Debtors or their Chapter 11 estates; and
>
> WHEREAS, the Debtors desire that the Prepetition Senior Lenders prosecute all Avoidance

> Claims on behalf of the Debtors in order to avoid burdening the Debtors' estates with further litigation expense.

Id. at 3. The Authorization Stipulation contained the following agreements, among others:

> A. The Prepetition Senior Lenders shall have the right, but not the obligation, to commence and prosecute adversary proceedings in the name of, and on behalf of, the Debtors, to recover Avoidance Recovery Property. With respect to any Avoidance Actions that the Prepetition Senior Lenders elect not to pursue, such Avoidance Actions shall be the subject of further order of the Court following the earlier of: (I) the full adjudication of all Avoidance Actions commenced by the Prepetition Senior Lenders, and (ii) 60 days before the expiry of the statute of limitations with respect to such actions.
>
> B. The Prepetition Senior Lenders shall have authority, but shall not be required, to settle any or all of the Avoidance Claims on terms satisfactory to the Prepetition Senior Lenders subject to the provisions of Bankruptcy Rule 9019; . . .
>
> C. The Agent for the Prepetition Senior Lenders shall have the authority to collect all Avoidance Recovery Property, net of reasonable costs of collection which shall be subject to Court approval, in repayment of the indebtedness secured by the Replacement Lien subject to disgorgement by the Agent for the Prepetition Senior Lenders to the extent that such net proceeds actually paid over to the Agent for the Prepetition Senior Lenders exceed the greater of: (i) the Replacement Lien; (ii) the Replacement Lien plus the amount of the pro rata share of the Prepetition Senior Lenders

> of any balance available for distribution to unsecured creditors; or (iii) the pro rata share of the Prepetition Senior Lenders of any amount available for distribution to unsecured creditors, all as may be determined by a final disposition of the determination of the extent of the Replacement Lien. . . .

Id. at 4-5.

Following the entry of the Authorization Stipulation, Mellon, on behalf of and in the name of, the Debtors, commenced a number of adversary proceedings with respect to Avoidance Claims, including the actions against GE and DC. In addition, Mellon commenced an action on behalf of the Debtors' estates seeking to avoid and recover preferential transfers made to Mitsubishi International Corporation ("Mitsubishi") and other related parties in the amount of $13 million. The Bankruptcy Court approved and authorized a settlement of that action in April 2001. Appellant's Exh. 22, Mitsubishi Settlement Agreement. That settlement occurred within the primary bankruptcy case with notice to all creditors, including GE and DC.

The Mitsubishi Settlement Agreement, approved and authorized by the Bankruptcy Court stated, in relevant part:

> A. The Motion constitutes a core proceeding and this Court has jurisdiction over this proceeding and the Motion pursuant to 28 U.S.C. Sections 157 and 1334. Venue in these Cases and this Motion is proper in this district pursuant to 28 U.S.C. Section 157(b).
>
> * * *

E. Following the commencement of the Cases, the Debtors sought approval pursuant to Sections 363 and 365 of the Bankruptcy Code for the sale of substantially all of their assets appurtenant to the business operations of the Debtors in connection with their specialty bar quality steel mill in Pitssboro [sic], Indiana (the "SBQ Assets") and with their iron carbide facility in Corpus Christi, Texas (the "IC Assets") (the "Sale"). By Order dated August 13, 1999 [(the "Sale Order")], the Court approved the Sale to the Prepetition Senior Lenders or their designee.

F. On or about August 26, 1999, the Sale was consummated and the SBQ Assets were transferred to Qualitech SBQ and the IC Assets were transferred to Qualitech IC.

G. On or about June 24, 1999, MISI filed Proof of Claim No. 295 in the amount of $96,432.83 and Mitsubishi filed Proofs of Claim Nos. 372 and 373 in the respective amounts of not less than $8,821,285.90 and $376,641.50 (together with all other claims, causes of action, rights and interests, known and unknown, now existing or hereinafter arising, in law and in equity, respecting the Debtors and their estates, the Contracts and the IC Plant (the "Mitsubishi Claims")[)].

H. On or about November 29, 1999, the Prepetition Senior Lenders filed an objection to Mitsubishi claim number 372 (the "Claim Objection").

I. In connection with and as provided in the Sale Order, on October 22, 1999[,] Qualitech IC and the Prepetition Senior Lenders moved pursuant to Sections 365 and 105 of the Bankruptcy

Code for an order approving the assumption by the Qualitech and the assignment to Qualitech IC of the Contracts, with a determination that the cure amount required for assumption was zero or, in the alternative, for a deferral of the time by which the Contracts must be designated for assumption and assignment (the "Assumption Motion").

J. The Claim Objection and the Assumption Motion constitute "contested matters" in the Cases within the contemplation of Bankruptcy Rule 9014.

K. By Order dated March 14, 2000 (the "Replacement Lien Order"), the Court: determined. . . . there was a diminution in value of the collateral of the Prepetition Senior Lenders in an amount exceeding $30,000,000; held the Replacement Lien of the Prepetition Senior Lenders to attached [sic] to the assets of the Debtors, including the Avoidance Recovery Property;. . . .

L. On June 8, 2000, the Court entered that certain . . . [Authorization Order] and thereby authorized Mellon to commence, prosecute and settle adversary proceedings in respect of avoidance claims of the Debtors arising under and by virtue of Chapter 5 of the Bankruptcy Code in the name of and on behalf of the Debtors.

M. Mellon, on behalf of the estate, commenced: . . . adversary proceeding number 00-381 against Mitsubishi seeking to avoid as preferential and/or fraudulent certain transfers . . . the complaint in such action seeking the recovery on behalf of the estate of Avoidance Recovery

Property within the contemplation of the Authorization Order and the Replacement Lien Order.

N. The totality of the litigation between Mellon, on behalf of the estate[s] and in its capacity as Collateral Agent for the Prepetition Senior Lenders, and the Mitsubishi Parties (the "Litigation"), . . . is extremely complex and involves a multitude of hotly contested facts both of a technical and non-technical nature. . . . [T]he litigation comprises several complex legal issues which have engendered, and in all probability will continue to engender, extensive motion practice and require substantial judicial resources to resolve. The prosecution of the Litigation on behalf of the estates has consumed and will continue to consume significant legal fees and litigation expenses, all of which, to the extent reasonable, will diminish a net recovery to the estates.

* * *

P. . . . [T]he Settlement is fair and equitable to the estates, will conserve judicial resources, and is in the best interests of the estates.

Q. The payment to the estates of sixty-five percent of the Settlement Amount (as defined below), net of the reasonable expenses of the Litigation, as set forth in the Motion, is well within the range of reasonableness in the context of the Cases and the Litigation.

NOW, THEREFORE, IT IS HEREBY ORDERED as follows:

* * *

> 3. At the Closing and in the manner specified in the Agreement: Mitsubishi indefeasibly shall pay to Mellon the sum of fifteen million dollars . . . of which 65% shall be allocated to the estates and 35% shall be allocated and paid over to the Purchasers (as defined by the Motion) (each net of expenses of Litigation); and the Letters of Credit shall be returned to Mitsubishi by Mellon, and upon such payment, the Letters of Credit shall be deemed canceled and the Prepetition Senior Lenders shall be deemed to have released their security interests therein.

Id. at 2-7.

The proceedings giving rise to the instant suit was commenced by Mellon, on behalf of the estates, on June 15, 2000, against GE and DC to recover the allegedly preferential payments made to GE and DC, respectively. On January 23, 2001, Mellon moved for summary judgment against the Defendants requesting, *inter alia,* that the Bankruptcy Court find as a matter of law that the transfers made to Defendants by Qualitech during the ninety days preceding the commencement of the Chapter 11 cases were preferential and/or fraudulent transfers pursuant to Sections 547 and 548 of the Bankruptcy Code, and that Mellon was entitled to judgment on those transfers against the Defendants under Section 550 of the Bankruptcy Code.

On the same date, both GE and DC filed cross-motions for summary judgment against Mellon. The Defendants argued that (1) Mellon lacked standing to pursue Avoidance Claims on behalf of the estate under Section 547 of the Bankruptcy Code, (2) that the recovery of the Avoidance Claims produced no benefit to the estates under

Section 550 of the Bankruptcy Code; and that, in the alternative, (3) the Bankruptcy Court lacked jurisdiction over the matter because Qualitech had abandoned its interest in the Avoidance Claims.

Two months later, in March 2001, the Debtors, through counsel, commenced as co-plaintiff in excess of ninety adversary proceedings to recover preferential transfers on behalf of the Debtor's estate. DeMarco, Aug.15, 2001, Decl. ¶ 2. Each complaint filed with the Bankruptcy Court contains an averment signed by Debtors' counsel that the Bankruptcy Court had subject matter jurisdiction over the actions. *Id.* Once the pending adversary proceedings, which "involve disputes among creditors over preferences, warranties, cure payments and liens," have been resolved, Debtors' counsel intends to dismiss the bankruptcy petition. Appellee's Exh. 3, Exh. C, Kohn Decl. ¶ 10.

The Bankruptcy Court held a hearing on the motions in this cause on February 15, 2001. By order dated August 6, 2001, the Bankruptcy Court denied Mellon's Motion for Summary Judgment and granted the Defendants' Motions for Summary Judgment. Order Granting Defs' Mot. for Summ. J., Aug. 6, 2001, at 1-2 ("Bank. Ct. Summ. J. Order"). The Bankruptcy Court found that

> Mellon cannot bring the Avoidance Actions because the Avoidance Claims were part of the collateral that was included in the "Assets" that were sold on August 13, 1999. Consequently, the dispute here is between non-debtors which does not involve property of the Debtors' estates and therefore the Bankruptcy Court does not have subject matter jurisdiction over these actions.

> In the alternative, the Defendants argue that, even if the Avoidance Claims were still property of the Debtors' estates, Mellon nevertheless lacks standing to bring these actions since only a trustee or debtor in possession is statutorily authorized to pursue such claims.

Id. at 10-11. To support these conclusions, the Bankruptcy Court found the following facts:

> 7. The Sale Order defines the property to be sold as the "Assets". The "Assets", in turn, consist of "all the Debtors' right, title and interests in and to the Collateral described by and contained in the Final Financing Order." See, footnote 2, page 4 of the Sale Order. The Final Financing Order, in turn defines "Collateral" as that term was defined in Section 5.2 of the document titled "Credit Agreement" which was attached as Exhibit A to the Final Financing Order. See DC Exhibit 4, Ex. A, Sec. 5.2.
>
> 8. Section 5.2 of the Credit Agreement, in turn, defines the Collateral as including "all Avoidance Recovery Property and Avoidance Claims of each of the Borrower and the Parent," i.e. Qualitech Steel Corporation and Qualitech Steel Holdings Corporation.
>
> 9. "Avoidance Claims" are defined in the Credit Agreement as "Any claim of either of the Borrower or the Parent to avoid a transfer by either of the Borrower or the Parent under the Bankruptcy Code, including, without limitation, any claim for avoidance arising under sections 542, 544, 546, 548, 549, 550, 551 or 553 of the Bankruptcy Code or otherwise."
>
> 10. "Avoidance Recovery Property" is defined in the Credit Agreement as "Any property

of either the Borrower or the Parent that has been or could be recovered through the successful pursuit of an Avoidance Claim." INDIANAPOLIS DIVISION, at p. 2.

11. On August 23, 1999, the sale of the Debtors' "assets" (as defined in the Sale Order) to the Prepetition Lenders closed. The assets used in connection with the Debtors' SBQ Facility were transferred to Qualitech Steel SBQ LLC and the assets used in connection with the I/C Plant were transferred to Qualitech Steel Iron Carbide Corp. (together, the "Purchasers"). As is acknowledged by Debtors' counsel, though, as of January 28, 2001, and as a result of the sale "all of Qualitech's assets have been sold or transferred and there are presently no assets in the bankruptcy estate to distribute." McIlvian Decl., Exh. C. ¶ 5.

* * *

19. . . . [C]ertain provisions [of the Authorization Stipulation] allowed the Prepetition Lenders to take action on their own. In particular, the Authorization Stipulation provides the Prepetition lenders with the authority to collect all proceeds of avoidance claims, net of collection costs, including attorneys fees, in repayment of their replacement lien. [Authorization Stipulation, ¶ C.] The Authorized Stipulation provided that these net proceeds of the Avoidance Claims might be "subject to disbursement" (as opposed to required to be paid) to the Debtor's estate [sic] *only if* the net proceeds exceed $30 million (e.g. the amount of the Replacement Lien), [*id.*]; and, until such time as the net proceeds in the avoidance claims exceed $30 million, the Authorized Stipulation provided that the automatic stay was modified to

> give the Prepetition Lenders the right to collect the net proceeds and apply these moneys [sic] to their debt. [*Id.* ¶¶ C, F.]
>
> 20. Although the Authorization Stipulation did not prevent or prohibit the Debtors from commencing any Avoidance Claim on their own behalf, it was recited in the Authorization Stipulation that the Debtors decided not to bring the avoidance action because they "determined that there is no equity in the Avoidance Claim for the Debtors or their Chapter 11 estates." [*Id.* at 3.]

Id., at 4-9.

II. STANDARD

When it reviews a decision of the Bankruptcy Court, the District Court acts as an appellate tribunal. Therefore, its review is governed by traditional standards of appellate review. Specifically, the Court "is constrained to accept the bankruptcy court's findings of facts unless they are clearly erroneous." *In re Excalibur Auto Corp.*, 859 F.2d 454, 457 n.3 (7th Cir. 1988). *See also In re Fedpak Sys., Inc.*, 80 F.3d 207, 211 (7th Cir. 1996); *In re Longardner & Assocs., Inc.*, 855 F.2d 455, 459 (7th Cir. 1988). "A finding is clearly erroneous if upon review of the entire record the reviewing court is left with the definite and firm conviction that a mistake has been committed." *Graham v. Lennington,* 75 B.R. 693, 695 (S.D. Ind. 1987). *See also Bowyer v. United States Dep't of Air Force,* 875 F.2d 732, 636 (7th Cir. 1989), *reh'g denied.* "Generally, as long as the bankruptcy judge's inferences are reasonable and supported by the evidence, they will not be disturbed." *Graham,* 75 B.R. at 695.

However, conclusions of law made by the Bankruptcy Court must be reviewed *de novo*. *See Excalibur Auto Corp.*, 859 F.2d at 457 n.3; *Longardner & Assocs., Inc.*, 855 F.2d at 459. And, where the challenged finding is a mixture of law and fact, the clearly erroneous standard is also inapplicable. *See Graham*, 74 B.R. at 965. With these general standards in mind, the Court will address the issues raised in the instant appeal.

III. DISCUSSION

A. THE PROCEDURAL POSTURE OF THIS CASE

At the outset, the Court must address the procedural posture of the questions before it. In its briefs Mellon repeatedly refers to the error by the Bankruptcy Court in resolving questions of fact. In other words, Mellon argues that summary judgment in favor of the Defendants on the issue of subject matter jurisdiction was improper because there were underlying factual disputes related to the terms of the sale of the Debtors' assets. However, regardless of the procedural posture in which the Defendants' arguments were raised regarding subject matter jurisdiction, the law on dismissal for lack of subject matter jurisdiction is clear: A court deciding whether or not it has subject matter jurisdiction "is free to weigh the evidence to determine whether jurisdiction has been established. Factual findings rendered during this process are reviewed for clear error." *United Phosphorus, Ltd. v. Angus Chem. Co.*, 322 F.3d 942, 946 (7th Cir. 2003) (en banc) (citations omitted). *See also Grafon Corp. v. Hausermann*, 602 F.2d 781, 783 (7th Cir. 1979); *Ace-Chi. Great Dane Corp.*, No. 89 C 8456, 1992 WL 44398, at *2 (N.D. Ill. 1992). In other words, the Bankruptcy Court must resolve the jurisdictional facts, and the ultimate decision of

subject matter jurisdiction is for the Bankruptcy Court not a jury. *See United Phosphorus,* 322 F.3d at 963 (J. Wood, dissenting) (citing 5A CHARLES ALAN WRIGHT & ARTHRU [sic] R. MILLER, FED'L PRACTICE & P. § 1350, at 234-35 (2d ed. 1990)). Within the procedural posture of this case regarding the Bankruptcy Court's subject matter jurisdiction, then, the Court will review the Bankruptcy Court's findings of fact for clear error, and its conclusions of law *de novo.* The party asserting jurisdiction bears the burden of proof. *Id.* at 946 (opinion of the court).

Mellon makes two primary arguments that the Bankruptcy Court's subject matter jurisdiction findings were in error.[2] First, it asserts that the Bankruptcy Court erroneously determined it lacked subject matter jurisdiction over Mellon's claims against GE and DC because the Avoidance Recovery Property and corresponding Avoidance Claims were in fact sold to the Purchasers in the Asset auction on June 30, 1999. Second, Mellon asserts that the Bankruptcy Court erroneously determined that Mellon lacked standing to bring this suit against GE and DC because Mellon's pursuit of those claims would confer no benefit to the estate under section 550 of the Bankruptcy Code. The Court will address each of these argument [sic] in turn.

---

[2] The Court notes that unlike most disputes about subject matter jurisdiction over third party actions, there is little dispute here about whether recovery of Avoidance Claims as a general matter are within the subject matter jurisdiction of the Bankruptcy Court. The dispute here focuses on specific facts of this case that might have divested the Bankruptcy Court of jurisdiction over the Avoidance Claims at issue.

B. SUBJECT MATTER JURISDICTION – PROPERTY OF THE ESTATE

Mellon first challenges the Bankruptcy Court's finding that the Avoidance Recovery Property was sold to the Purchasers as part of the asset sale; therefore, the Bankruptcy Court lacked subject matter jurisdiction over the instant claims. The Bankruptcy Court found that the definition of "Assets" sold to the Purchasers as described in the Sale Order included Avoidance Claims. Bank. Ct. Summ. J. Order, at 4-5. Specifically, the Bankruptcy Court looked to the definition of "Collateral" in the "Credit Agreement." *Id.* at 4. The Credit Agreement defined Collateral to include "all Avoidance Recovery Property and Avoidance Claims of each of the [Debtors]." *Id.* In addition, the Bankruptcy Court found that Debtors' counsel acknowledged during a hearing regarding another subject that as of January 28, 2001, and as a result of the asset sale, "'all of Qualitech's assets have been sold or transferred and there are presently no assets in the bankruptcy estate to distribute.'" *Id.* at 5 (quoting McIlvian Decl., Exh. C. ¶ 5).

Mellon asserts that these finding [sic] ignore other contradictory facts that were before the Bankruptcy Court. Mellon contends that the Sale Order did not effect the sale of the assets to the Purchasers, it merely approved and authorized it; therefore, the definition of "Asset" contained therein is not controlling as to what assets were sold. If anything, Mellon asserts, the Sale Order creates an ambiguity about the definition of "Assets." Specifically, the Sale Order defines "Assets" to include the Collateral described in two other documents: the Final Financing Order and the Prepetition Loan Documents. Sale Order, at 4 n.2. By their nature, the Prepetition Loan Documents

cannot include Avoidance Claims or Avoidance Recovery Property as Collateral because those types of property were not contemplated prior to the Debtors' bankruptcy filing. Therefore, Mellon asserts, the Bankruptcy Court erred when it failed to consider other evidence to resolve the ambiguity about what "Collateral" was actually sold to the Purchasers.

Moreover, the parties to the sale have never acted as if the Avoidance Claims or Avoidance Recovery Property were sold to the Purchasers. In a sworn statement, Jennifer C. DeMarco ("DeMarco"), counsel for Mellon and present at the closing, affirmed that the Avoidance Claims and/or Avoidance Recovery Property were not transferred out of the estate. Appellant's Exh. 17, DeMarco Decl. ¶ 2. In addition, at the auction, the "assets" were described as "two facilities" and several leases and executory contracts associated with those two facilities. Sale Tr. at 5-8. Furthermore, the Purchasers have never acted as if they owned the Avoidance Claims. In fact, Mellon, the Debtors, the Purchasers and the Bankruptcy Court proceeded as if the Avoidance Claims remained part of the estates as evidenced by the suit against Mitsubishi and related entities, and subsequent settlement thereof. Specifically, the settlement agreement approved by the Bankruptcy Court reflects that the estates recovered the portion of settlement attributed to the Avoidance Claims while the Purchasers recovered the portion of the settlement attributed to non-estate claims. Appellant's Exh. 22, Mitsubishi Settlement Agreement ¶¶ Q & 3. Mellon argues that these facts clearly demonstrate that the Avoidance Claims and/or Avoidance Recovery Property were not part of the sale to the Purchasers.

In contrast, the Defendants contend that the Bankruptcy Court properly looked to the Sale Order to determine what assets were sold. Moreover, the definition of Collateral referenced by the Sale Order clearly includes Avoidance Claims and Avoidance Recovery Property. Furthermore, Debtors' counsel, on or about January 26, 2001, by declaration in another matter, stated: "All of Qualitech's assets have now been sold or transferred and there are presently no assets in the bankruptcy estate to distribute." Appellee's App. Exh. 3, McIlvain Decl., Exh. C, Kohn Decl. ¶ 5 ("Kohn Decl."). Therefore, according to documents regarding the assets sold, and Debtors' counsel's understanding of the assets remaining in the estates, the Bankruptcy Court was correct in concluding that the Avoidance Claims and Avoidance Recovery Property were sold to the Purchasers. Furthermore, DeMarco's affidavit is conclusory when it states that the Avoidance Claims and Avoidance Recovery Property were not included in the assets transferred to the Purchasers after the sale; therefore, the Bankruptcy Court correctly excluded it from consideration. In addition, the Defendants argue that the preference suits filed by the Debtors' estate after the motions for summary judgment were filed in this case cannot support Mellon's argument that the Avoidance Claims and Avoidance Recovery Property remained in the estates.

The Court finds that the Bankruptcy Court committed clear error when it determined that the Avoidance Claims and Avoidance Recovery Property were sold as part of assets to the Purchasers. The Court must start with the definition for "Assets" in the Sale Order. That definition references the definitions for "Collateral" in two documents, the Final Financing Order and the Prepetition

Loan Documents. The definition of "Collateral" in the Final Financing Order includes "personal and real property of the Debtors or their estates, of any kind or nature whatever . . . as more particularly described in the Credit Agreement." Appellant's Exh. 3, Final Financing Order, at 2. The Credit Agreement specifically describes "Avoidance Recovery Property and Avoidance Claims of each of the Borrower and the Parent" *Id.* Exh. A. But, the definition of "Collateral" in the Prepetition Loan Documents does not include Avoidance Claims or Avoidance Recovery Property. Therefore, the Sale Order's reference to the two documents to define the assets sold creates an ambiguity, which must be resolved by looking at other facts.

It is clear from the Sale Order that the Bankruptcy Court was approving the sale of assets that had occurred at the auction held on June 30, 1999. The transcript from the auction clearly describes the assets being sold: "two facilities" and several leases and executory contracts associated with those two facilities. Sale Tr. at 5-8. There is no reference to other personal property of the Debtors. Furthermore, on or about February 5, 2001, DeMarco, counsel for Mellon, declared that she had personal knowledge of the extent of the sale to the Purchasers and that the assets sold did not include either Avoidance Claims or Avoidance Recovery Property. Appellant's Exh. 17, DeMarco Decl. ¶ 2. Although this statement seems to contradict that of Debtors' counsel, Kohn, in another proceeding, the Bankruptcy Court apparently ignored other relevant facts consistent with DeMarco's statement and inconsistent with Kohn's statement. First, the declaration in which Kohn made the allegedly contradictory statement also alludes to further proceedings that must occur before the bankruptcy estates could be closed.

Appellee's Exh. 3, Kohn Decl. ¶¶ 10-11. Specifically, he declared:

> 10. Barnes & Thornburg's only remaining task as counsel to Qualitech in the bankruptcy proceeding is to dismiss the bankruptcy petition after all remaining "adversary proceedings" are completed. These proceedings involve disputes among creditors over preferences, warranties, cure payments and liens have been litigated and settled [sic] .
>
> 11. Barnes & Thornburg has no role in the adversary proceedings or disputes over preferences, warranties, cure payments and liens and Qualitech has no interest in those proceedings because the bankruptcy court has assigned all of Qualitech's interest to other parties. To the extent the adversary proceedings generate any additional assets for distribution, the bankruptcy court has already entered orders directing how those assets will be distributed.

Id. His statements here allude to further adversary proceedings in which Qualitech would not participate because the Bankruptcy Court had "assigned" those assets to other interested parties. But, the record indicates that the Avoidance Claims and Avoidance Recovery Property had not been "assigned" or otherwise transferred. Specifically, the Replacement Lien Order specifically grants the Prepetition Senior Lenders a security interest on "the assets of the Debros [sic] comprising the Collateral, including the Avoidance Recovery Property, other than those assets transferred pursuant to the Sale Order." No assignment or transfer of property occurs here; rather, a lien is created on the Avoidance Recovery Property. Based upon the Bankruptcy Court's reference to the sale in the same

sentence, the Avoidance Recovery Property was not an asset transferred pursuant to the Sale Order.

Neither is an assignment or transfer of the Avoidance Claims and/or Avoidance Recovery Property made later when the Bankruptcy Court authorized the stipulation. Specifically, the Authorization Stipulation gave the Prepetition Senior Lenders the right, but not the obligation, to pursue adversary proceedings on behalf of the estates. Authorization Stipulation, at 4, ¶¶ A, B, C. Moreover, the Bankruptcy Court specifically allowed for instances where the Prepetition Lenders chose not to pursue Avoidance Actions. *See id.* ("With respect to any Avoidance Actions that the Prepetition Senior Lenders elect not to pursue, such Avoidance Actions shall be the subject of further order of the Court. . . . "). The Authorization Stipulation required disgorgement of Avoidance Recovery Property collected by the Prepetition Senior Lenders when the net proceeds exceeded certain values. *Id.* at 5, ¶ C. The disgorged funds would be available for distribution to unsecured creditors of the estates. *Id.* Clearly this specific plan for pursuit and recovery of Avoidance Recovery Property would have been unnecessary if the Avoidance Claims and/or Avoidance Recovery Property had been sold to the Purchasers. Moreover, the orders give the Prepetition Senior Lenders the right to pursue the Avoidance Claims on behalf of the estates; there is no assignment or sale of the property.

Likewise, the Bankruptcy Court's later approval of the Mitsubishi Settlement Agreement pursuant to the Replacement Lien Order and the Authorization Stipulation confirms that the parties to the Asset Sale, including the Debtors and the Purchasers, were treating the Avoidance Claims and the Avoidance Recovery Property as assets

retained by the estates and subject to further orders of the Bankruptcy Court. While it is true that a party may contest jurisdiction at any point in a proceeding notwithstanding prior orders in the case, as argued by the Defendants here, the fact that the Purchasers did not proceed against either Mitsubishi or the Defendants in this case are facts that tend to show that the Avoidance Claims and Avoidance Recovery Property were not sold. The Mitsubishi Settlement Agreement discloses that the amount recovered in that action is in the millions. Appellant's Exh. 22, Mitsubishi Settlement Agreement ¶ 3. Furthermore, the amounts allegedly recoverable in the instant claims are considerable. It is reasonable to infer that the Purchasers would have tried to pursue these claims on their own behalf if they had purchased the Avoidance Claims and Avoidance Recovery Property at the Asset Sale.[3]

In addition, the Purchasers received a share of the Avoidance Recovery Property recovered in the Mitsubishi Settlement Agreement that was associated with non-estate claims. *Id.* Clearly this division of the proceeds from the Mitsubishi litigation would not have occurred if the Avoidance Claims and Avoidance Recovery Property were sold to the Purchasers; the Purchasers would have been [sic] claimed the entirety of the proceeds if they owned the claims.

Based on the facts and history of this case and upon review of the entire record, the Court "is left with the definite and firm conviction that a mistake has been

---

[3] The Court expresses no opinion on whether the Purchasers would have standing to pursue such claims in the Bankruptcy Court or whether such claims would be successful.

committed." *Graham,* 75 B.R. at 695. The Bankruptcy Court's finding that the Avoidance Claims and/or Avoidance Recovery Property were sold to the Purchasers at the Asset Sale was clear error. Therefore, the Bankruptcy Court's conclusion that it lacked subject matter jurisdiction over the instant action was also in error. The decision of the Bankruptcy Court on the issue of lack of subject matter jurisdiction because the Avoidance Claims and/or Avoidance Recovery Property had been sold to the Purchasers is hereby **REVERSED**.

C. STANDING

Mellon next asserts that the Bankruptcy Court erred when it concluded that Mellon lacked standing to bring Avoidance Claims against the Defendants. Specifically, Mellon challenges the Bankruptcy Court's finding that "the instant avoidance actions do not meet the 'for the benefit of the estate' requirement under § 550" of the Bankruptcy Code. Bank. Ct. Summ. J. Order, at 2. To support this conclusion, the Bankruptcy Court found the following facts:

> 24. At the February 15th oral argument on the cross motions for summary judgment, counsel for Mellon admitted that the avoidance actions will not exceed 30 million dollars, thus preventing the estate from receiving any proceeds of the preference actions.
>
> 25. The Debtor's counsel's sole remaining task is to dismiss the bankruptcy petition after all remaining adversary proceedings have been completed. *See* McIlvain Dec. [sic], Exh. C, ¶¶ 5, 10. These adversary proceedings "involve disputes *among creditors over preferences,* warranties,

> ties, cure payments and liens . . . " and Qualitech has no interest in these proceedings. McIlvain Dec. [sic], Exh. C, ¶¶ 10, 11 (emphasis added).

Id. at 10. Mellon argues that the Bankruptcy Court erred when it found that the $30,000,000.00 post-petition loan did not benefit the estate. Mellon cites *P.A. Bergner & Co. v. Bank One, Milwaukee, N.A. (In re P.A. Bergner & Co.),* 140 F.3d 111, 1118 (7th Cir. 1998), *Citicorp Acceptance Co. v. Robison (In re Sweetwater),* 884 F.2d 1323 (10th Cir. 1989), and *In re Trans World Airlines,* 163 B.R. 964, 969-71 (Bankr. D. Del. 1994), for the proposition that a "benefit to the estate" need not occur after the recovery of an Avoidance Claim, but rather may have occurred long before an avoidance action was filed. The Bankruptcy Court declined to accept this argument stating, in relevant part:

> [U]nlike the situations in either *Bergner* or *Trans World Airlines,* unsecured creditors in this case have received nothing. There was no plan. There was no reorganization, and unsecured creditors have no stake in the success of the reorganized debtor because there is no reorganized debtor. There was no fund established from which proceeds are to be distributed to unsecured creditors. As recovery of the avoidance claims will not reach the $30 million threshold, the Prepetition [Senior] Lenders will be the sole beneficiaries of the requested recoveries from Dick Corporation and GE Supply, bringing these action[s] will not inure to the benefit of the estate.
>
> 29. There is no bankruptcy or reorganizational purpose to be served by permitting this action to go forward particularly where, as here, there is no plan, there will be no distribution to unsecured

> creditors and the bankruptcy case, upon conclusion of these preference actions, will be dismissed. "Where recovery will benefit an entity other than the estate, Section 550's requirement that recovery be for the benefit of the estate is not satisfied." *In re Huntsville Small Engines, Inc.*, 228 B.R. 5, 13 (Bankr. N.D. Ala. 1998); *In re Metal Brokers Int'l, Inc.*, 225 B.R. 920 (Bankr. E.D. Wis. 1998). *See also In re Burlington Motor Holdings, Inc.*, 231 B.R. 874, 877 (Bankr. D. Del. 1999 (holding that successor corporation which had acquired all of the Chapter 11 debtors' assets lacked standing to bring preference actions, as "any recovery by the Successor Corporation is not for the benefit of the estate as required by § 550(a)"). *See also Congress Credit Corp. v. AJC Intern.*, 186 B.R. 555 (D.P.R. 1995) (finding no benefit to the estate and party asserting claims has no standing where party asserting preference action had a lien on the proceeds of the recovery of preference actions, requiring proceeds to go directly to that party and where unsecured creditors received none of the proceeds).

Id. at 24-25.

In contrast, the Defendants assert that the Bankruptcy Court properly determined that the avoidance claims in the instant suit would not produce a benefit to the estates. Because Mellon has admitted that the Prepetition Senior Lenders would be the only beneficiary of any money recovered from this suit, the Defendants argue that there is no benefit to the estates. Therefore, Mellon cannot have standing to pursue the claims pursuant to § 550. The Defendants also aver that the instant claims have not been properly assigned to Mellon pursuant to § 1123 of the Bankruptcy Code, therefore, the assignment provisions do

not help Mellon's case. GE and DC also argue that *Trans World Airlines* does not apply in this case because unlike in this case, the avoidance actions in *Trans World Airlines* were brought by a representative of the estate pursuant to a confirmed plan. There is no such plan in the instant suit. Defs.' Am. Resp. Br., at 21. Moreover, the facts of the instant case are different from those in *Bergner* where the estate's representative funded a $0.33 on the dollar payout to unsecured creditors under a reorganization plan. *Id.* Furthermore, the Defendants argue that notwithstanding the Authorization Order, the plain meaning of § 547 of the Bankruptcy Code prohibits anyone other than the trustee from bringing an Avoidance Claim. *Id.* at 22-25.

The Court finds that Mellon lacks standing to bring the instant claims. At the outset, the Court notes that the circumstances of this case are fairly unique in the context of the avoidance actions at issue in this case. The underlying bankruptcy case was filed under Chapter 11 for reorganization of the debtors. However, no reorganization plan was ever filed and the real and personal property of the debtors was sold. In that respect the case has proceeded more like a case filed under Chapter 7 for liquidation. In addition, no trustee has ever been appointed and the original counsel for the debtors has stated in the past that after the avoidance claims are closed, there is no work left for the bankruptcy court. As a result of these unusual circumstances, the parties have presented no precedential case law directly on point, nor was the Court able to find any.[4] Therefore, the Court must carefully focus on the

[4] There is one unpublished district court opinion worth noting because it comes close to the factual scenario of this case. *All Star Int'l*

(Continued on following page)

statutes under which Mellon seeks to recover in this case, law interpreting those statutes or closely analogous statutes, and the facts of this case. The facts pertinent to the standing issue are not in dispute.

Standing is an issue of law; therefore, the Court reviews the Bankruptcy Court's findings *de novo*. *See In re Davis,* 194 F.3d 570, 573 (5th Cir. 1999). *Cf. In re James Wilson Assocs.,* 965 F.2d 160, 168 (7th Cir. 1992) (treating an the issue of standing as one of law to review *de novo*). To have standing to invoke a statute, in this case § 550, Mellon must be one of the entities that the statute is intended to protect. *See In re James Wilson Assocs.,* 965 F.2d at 168; *Tucker v. Dep't of Commerce,* 958 F.2d 1411, 1416 (7th Cir. 1992). Section 550 states, in pertinent part:

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or,

---

Trucks, Inc. v. Burlington Motor Carriers, Inc. (In re Burlington Motor Holdings, Inc.), No. 95-1559(JFK), 2002 WL 63595 (D. Del. Jan. 17, 2002). Pursuant to a plan of reorganization, the new owners of the debtor paid an amount to be distributed directly to the unsecured creditors and assumed liability for other types of claims. *Id.* at * 3. In exchange for this consideration, the new owners received substantially all of the debtors assets including the avoidance claims. *Id.* The court in *Burlington Motor Holdings* found that it would be inequitable not to allow the creditor to pursue the actions because it had bargained for the right to do so, and the original bargain had benefitted the estate, including unsecured creditors at the time it was made. *Id.* (citing *In re Maxwell Newspapers, Inc,* 189 B.r [sic] 282 (Bankr. S.D.N.Y. 1995); *In re Churchfield Mgmt. & Inv. Corp.,* 122 B.R. 76 (Bankr. N.D. Ill. 1990)).

> if the court so orders, the value of such property. . . .

11 U.S.C. § 550(a).

A plain reading of the statue [sic] would require that the trustee recover any avoidance recovery property for the benefit of the estate. Similarly, the language of § 547 and § 548, which form the basis for Mellon's claims against the Defendants, refer to "the trustee" as the operative party.[5] *Id.* § 547 (stating that "the trustee may avoid any transfer of an interest of the debtor in property . . . . "); *id.* § 548 (stating that "[t]he trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition. . . . "). In other words, under a plain reading of the statutes at issue, there are two questions, whether or not Mellon may stand in the shoes of the trustee and whether or not recovery by Mellon would benefit the estate.

When the Bankruptcy Court analyzed these two questions, it determined that the question of whether or not a creditor may stand in the shoes of the trustee turned on whether the creditor was pursuing interests common to all creditors. Bankr. Ct. Summ. J. Order, at 16 (citing *Ducker Spradling & Metzger v. Baum Trust (In re P.R.T.C., Inc.),* 177 F.3d 774, 781 (9th Cir. 1999)). *See also id.* at 17-20 (analyzing the "representative of the estate" element of

---

[5] Section 1107(a) gives a debtor-in-possession similar power. 11 U.S.C. § 1107(a) (stating that subject to certain limitations, "a debtor in possession shall have all the rights . . . , and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter").

§ 1123 and determining that the focus of the inquiry is whether the appointed representative's recovery would benefit the estate (citing *In re Sweetwater,* 884 F.2d 1323, 1327 (10th Cir. 1989); *In re Trans World Airlines, Inc. v. Travellers Int'l AG,* 163 B.R. 964, 973 (Bankr. D. Del. 1994); *N. Atl. Millwork Corp.,* 155 B.R. 271 (Bankr. D. Mass. 1993)). Therefore, the Bankruptcy Court focused its analysis on whether Mellon's recovery in this case would benefit the estate.

There is no question that in certain circumstance [sic] some courts have allowed individual creditors to bring avoidance actions on behalf of a trustee or a debtor. *See Avalanche Maritime, Ltd. v. Parekh (In re Parmatex, Inc.),* 199 F.3d 1029 (9th Cir. 1999); *Duckor Spradling & metzger v. Baum Trust (In re P.R.T.C., Inc.),* 177 F.3d 774 (9th Cir. 1999); *Canadian Pac. Forest Prods. Ltd. v. J.D. Irving, Ltd. (In re Gibson Group),* 66 F.3d 1436 (6th Cir. 1995); *In re STN Enters.* 779 F.2d 901 (2d Cir. 1985); *McCarthy v. Navistar Fin. Corp. (In re Vogel Van & Storage, Inc.),* 210 B.R. 27, 32 (N.D.N.Y. 1997). *But see SouthTrust Bank v. WCI Outdoor Prods., Inc. (In re Huntsville Small Engines, Inc.),* 228 B.R. 9 (N.D. Ala. 1998); *Met-al, Inc., v. Gabor (In re Metal Brokers Int'l, Inc.),* 225 B.R. 920 (E.D. Va. 1998); *Fleet Nat'l Bank v. Doorcrafters (MI of VT) (In re N. Atl. Millwork Corp.),* 155 B.R. 271 (D. Mass. 1993). Many of those courts require special circumstances to exist before the creditor has standing. *See Parmatex, Inc.,* 199 F.3d at 1031 (requiring that the trustee stipulate that creditor could sue on his behalf and the bankruptcy court approved such stipulation); *In re P.R.T.C.,* 177 F.3d at 781 (requiring that a creditor pursue "interests common to all creditors"); *In re Gibson Group,* 66 F.3d at 1446 (requiring that a creditor or creditor committee show four elements before it

may have derivative standing, including that the inaction of a trustee or debtor in possession is "an abuse of discretion" or unjustified); *In re STN Enters.* 779 F.2d at 904 (requiring that the bankruptcy court approve creditor's action and that creditor show that debtor in possession had unjustifiably failed to initiate adversary proceeding); *In re Vogel Van & Storage,* 210 B.R. at 32 (requiring extraordinary circumstances, and finding them under the facts presented where the estate would maximize its recovery for the benefit of all creditors because the creditor had insulated the estate from loss by promising to pay the estate regardless of the outcome of the suit).

Although never squarely addressing the issue, the Seventh Circuit has suggested that a creditor may bring a form of derivative suit in the name of the debtor to recover for allegedly fraudulent conveyances; however, the creditor must first "convince the court that the debtor was shirking its statutory responsibilities." *In re Xonics Photochem., Inc.,* 841 F.2d 198, 203 (7th Cir. 1988) (citing *In re Automated Bus. Sys., Inc.,* 642 F.2d 200 (6th Cir. 1981); *In re Jones,* 37 B.R. 969 (Bank. N.D. Tex. 1984); *cf. Fox Valley AMC/Jeep, Inc. v. AM Credit Corp.,* 836 F.2d 366 (7th Cir. 1988)). This requirement is similar, in part, to the view adopted by the Sixth Circuit, which requires satisfaction of four elements before a creditor may have standing to initiate an avoidance action:

> 1) a demand has been made upon the statutorily authorized party to take action; 2) the demand is declined; 3) a colorable claim that would benefit the estate if successful exists, based on a cost-benefit analysis performed by the court, and 4) the inaction is an abuse of discretion ("unjustified") in light of the debtor-in-possession's duties in a Chapter 11 case. A creditor has met its burden to show

> standing to file an avoidance action if it has fulfilled the first three requirements and the trustee or debtor-in-possession declined to take action without stating a reason. The burden then shifts to the debtor-in-possession to establish, by a preponderance of the evidence, that its reason for not acting is justified.

In re Gibson Group, 66 F.3d at1446. Moreover, the Sixth Circuit has also held that "the lack of funds to pursue the suit [is] a sufficient reason for permitting [a] creditor to proceed in the trustee's stead." *Id.* at 1443 (citing *In re Automated Bus. Sys.,* 642 F.2d at 201).

Presuming, without deciding, that the Seventh Circuit would adopt the approach of the Sixth Circuit, which requires the creditor to show four elements before it has standing to pursue avoidance claims, Mellon's case clearly falls short. The facts in the instant suit establish that Mellon and the Debtors proffered a stipulation to the Bankruptcy Court that stated

> the Debtors have analyzed the Avoidance Claims and determined that there is no equity in the Avoidance Claims for the Debtors or their Chapter 11 estates; and . . . the Debtors desire that the Prepetition Senior Lenders prosecute all Avoidance Claims on behalf of the Debtors in order to avoid burdening the Debtors' estates with further litigation expenses.

Appellant's Exh. 11, Authorization Stipulation, at 3. Having assumed that the Avoidance Claims were property of the estates, the Authorization Stipulation evidences that Mellon demanded that the Debtors take action, that the Debtors declined to take such action, and that the Debtors were "shirking [their] statutory responsibilities"

because they refused to pursue the Avoidance Claims to avoid the expense. *In re Xonics Photchem.*, 841 F.2d at 203.

But, the Sixth Circuit's test also requires that the creditor show that "a colorable claim that would benefit the estate if successful exists, based on a cost-benefit analysis performed by the court." *In re Gibson Group,* 66 F.3d at 1446. Although, arguably, the Authorization Stipulation provides the cost-benefit analysis for the Bankruptcy Court when it states that "the Debtors have analyzed the Avoidance Claims and determined that there is no equity in the Avoidance Claims for the Debtors or their Chapter 11 estates; and . . . the Debtors desire that the Prepetition Senior Lenders prosecute all Avoidance Claims on behalf of the Debtors in order to avoid burdening the Debtors' estates with further litigation expense," the analysis proves too much. The Authorization Stipulation states that the Debtors see no "equity" in the Avoidance Claims for either themselves or their estates. In the context here, the Court interprets "equity" to mean "value" or "benefit." Therefore, the evidence shows that regardless of whether or not a "colorable claim" exists, the Debtors and the Prepetition Senior Lenders agreed in the Authorization Stipulation that there is no benefit to the estates in recovering on the claims. Moreover, Mellon repeated this assertion in writing. Appellees' Exh. 4, Response of the Senior Lenders to Motion by Creditors' Committee to Determine Rights Under Financing Order or to Convert Cases Under Chapter 7, at 2 n.2. Under the Sixth Circuit's test for standing of a creditor to bring avoidance actions, Mellon has not shown the third element, that a colorable claim exists that would benefit the Debtors' estates if successful.

Even if the Seventh Circuit would apply a less stringent test than the Sixth Circuit and find that Mellon could stand in the shoes of a trustee or the Debtors in this case simply because the Debtor decided not to pursue them, the Court finds that the Bankruptcy Court correctly concluded that Mellon's recovery of any avoidance claims in this case would not "benefit the estate" as required by § 550. As discussed above, the Authorization Stipulation specifically delineates the Debtors' view that "there is no equity in the Avoidance Claims for the Debtors or their Chapter 11 estates." Appellant's Exh. 11, Authorization Stipulation, at 3. Mellon argues, however, that the benefit to the estate may have occurred prior to recovery of the avoidance property. Specifically, Mellon asserts that the Bankruptcy Court ignored

> the substantial benefit to the estate that resulted from the subordination of the [Prepetition Senior Lenders'] liens to new money, which permitted the Debtor[] to continue to meet its operating expenses to its employees and creditors (like GE Supply) in the ordinary course of its business and resulted in the distribution to the unsecured creditors in connection with the sale of a $7.5 million note.

Appellant Reply, at 8 (internal citations omitted). This is a "benefit" that occurred well prior to the recovery on any Avoidance Claims here. Mellon primarily relies upon three cases to support its position: *P.A. Bergner & Co. v. Bank One, Milwaukee, N.A. (In re P.A. Bergner & Co.),* 140 F.3d 111, 1118 (7th Cir. 1998), *Citicorp Acceptance Co. v. Robison (In re Sweetwater),* 884 F.2d 1323 (10th Cir. 1989), and *In re Trans World Airlines,* 163 B.R. 964, 969-71 (Bankr. D. Del. 1994). In *Bergner,* an alleged preference transferee argued that the *Bergner* debtor in possession lacked

standing to bring an avoidance action under § 550, in part, because the recovery would not benefit the estate. *In re P.A. Bergner,* 140 F.3d at 1118. The preference transferee argued that because the unsecured creditors had already recovered on their claims, pursuant to the approved reorganization plan, those creditors would not benefit from the recovery of any alleged preference transfer. *Id.* In addition, the preference transferee argued that recovery by the reorganized debtor would only benefit the new owners of the reorganized entity. *Id.*

The Seventh Circuit held that a benefit to the reorganized entity in that case was sufficient to satisfy the "benefit of the estate" requirement of § 550. *Id.* (citing *In re Acequia, Inc.,* 34 F.3d 800, 811 (9th Cir. 1994); *In re Trans World Airlines, Inc.,* 163 B.R. 964, 969-71 (Bankr. D. Del. 1994)). The Seventh Circuit reasoned that the benefit to creditors under § 550 need not be direct. *Id.* Under the facts in *Bergner,* the Seventh Circuit agreed that the new owners of the reorganized entity would benefit from recovery of the avoidance claims. But, the new owners were the debtor's largest under-secured creditor, which in exchange for the equity in the new entity, funded $25 million of the distribution to the general unsecured creditors of the debtor. *Id.* Therefore, the Seventh Circuit concluded that to prohibit the creditor from pursuing the claim "would be in serious tension with the right of the debtor under § 1123 to continue pursuing claims after plan confirmation, as that right would mean little if it could be defeated by showing that recovery would not go to the original creditor group in its original form." *Id.*

Similarly to the factual scenario in *Bergner,* in *Trans World Airlines,* the alleged preferential transferee argued that the debtor in possession lacked standing to bring an

avoidance action under § 550 because the recovery would go directly to a single creditor as payment on secured notes, rather than benefit the estate for payment to other creditors. *In re Trans World Airlines, Inc.,* 163 B.R. at 969. The single creditor had loaned a significant amount of money to the debtor in possession in exchange for secured, super priority notes, payable by a certain date or payable upon recovery of the preference claim at issue. *Id.* at 968.

The District Court of Delaware held that standing was proper. *Id.* The *Trans World Airlines* court reasoned that § 550 merely required a benefit to the "estate;" a broader term than "creditors." *Id.* at 972. "There is no requirement that an avoidance action recovery be distributed (or 'committed') in whole or in part to creditors." *Id.* Moreover, under the facts in *Trans World Airlines,* the reorganization plan provided that each "unsecured creditor[ ] received, in full satisfaction of their claims, a pro-rata share of $58,440,000 in principal amount of new seven-year notes and 3,365,000 shares of new preferred stock." Therefore, the *Trans World Airlines* court found that "not only do the unsecured creditors benefit as shareholders, they benefit as noteholders. To the extent that the recovery will enhance the value of reorganized TWA, the noteholders, as well as other creditors of TWA, will benefit." *Id.* at 973. Moreover, the court concluded that "[t]he basic purpose of a recovery pursuant to § 550(a) is to enlarge the estate for the benefit of creditors. Any recovery by TWA here will do that." *Id.*

The instant facts are significantly different. Unlike in *Bergner* or *Trans World Airlines* where there was a confirmed reorganization plan that provided for some recovery of claims by unsecured creditors, or provided that either under-secured or unsecured creditors obtain equity

in the reorganized debtor, there is no confirmed reorganization plan in this case. Therefore, the protections normally afforded unsecured creditors through the confirmation process are absent. Moreover, there is no evidence that the unsecured creditors in this case have a stake in any reorganized debtor. In fact, the parties agree that no creditor other than the Prepetition Senior Lenders will benefit from the avoidance action at bar. In other words, no one save the Prepetition Senior Lenders is better off because of the recovery action.

Mellon argues that the estate and thereby it creditors were benefitted in the past by the DIP financing because the loans provided payment for goods or services provided to the Debtors prior to the sale of substantially all of the Debtors' assets. In addition, the DIP financing allowed for the sale of an ongoing concern and, ultimately, the assignment of a $7.5 million note payable to the Official Unsecured Creditor's Committee by the Purchasers. Mellon avers that this was a significant benefit to the estate and the creditors; therefore, the "benefit of the estate" requirement of § 550 is met. But, under the circumstances of this case, there is no plan or other commitment of a benefit on the part of the Prepetition Senior Lenders directly or indirectly to the other creditors (whether secured or unsecured). In fact, it seems as if the transactions that occurred in this case were entirely for the benefit of the Prepetition Senior Lenders because the Prepetition Senior Lenders financed the Debtors until a sale to the Prepetition Senior Lenders, at a loss to the Prepetition Senior Lenders, so that the Prepetition Senior Lenders could recover Avoidance Claims to pay off their loss. In other words, recovery in this case benefits no one but the Prepetition Senior Lenders. Finally, there were

never any assurances by the Bankruptcy Court that the Prepetition Senior Lenders would recover more than their fair share of the proceeds of the asset sale; their interest in the Avoidance Recovery Property was always contingent on a proper showing of standing. *Cf. In re N. Atl. Millwork,* 155 B.R. at 284 (commenting that although the sale order in the case authorized pursuit of avoidance claims by a creditor, nothing prevented the defendants from contesting the creditor's standing).

Mellon also relies upon the case *In re Sweetwater,* 884 F.2d 1323 (10th Cir. 1989). However, the facts of that case are much different from the scenario here. In *Sweetwater,* the administrative claimants agreed to different treatment of their claims pursuant to a reorganization plan that was affirmed by the bankruptcy court. *Id.* at 1324. The reorganization plan called for each administrative claimant to receive an interest equal to the allowed amount of their claim in a fund of cash and assets. *Id.* at 1325. The assets included the potential proceeds from an avoidance claim against a certain bank. *Id.* A trustee of the fund was appointed by the reorganization plan to recover any proceeds from the avoidance claim, reduce the assets to cash and disperse the funds to the administrative claimants according to the agreed plan. *Id.* Any overage was to revert to the debtor's estate for further distribution to other creditors. *Id.* The bank challenged the standing of the trustee arguing that there was no benefit to the estate.

The *Sweetwater* court held that the trustee had standing. *Id.* at 1326. The *Sweetwater* court reasoned that it was clear that the trustee's obligation was to prosecute the avoidance claims for the benefit of the administrative claimants pursuant to the confirmed plan. *Id.* at 1327. Moreover, to the extent the claims paid more than required

by the administrative claims, there would be more funds available to satisfy other unsecured creditors. *Id.* The *Sweetwater* court also held that the claims were not "assigned" to the trustee, rather, the claims belonged to the estate consistent with 11 U.S.C. § 1123. *Id.*

The instant case is clearly distinguishable. As already discussed above, there was no plan in this case in which any creditors agreed to different treatment of their claims. There was an agreement by the Prepetition Senior Lenders to subordinate their loans; however, that agreement did not purport to change the status of any other creditor's claim. Furthermore, there was no agreement by the creditors in this case to appoint Mellon or the Prepetition Senior Lenders to represent the interests of the creditors. To the contrary, the Official Creditors' Committee has asserted itself against the Prepetition Senior Lenders on other issues. *See In re Qualitech Steel Corp.,* 276 F.3d 245 (7th Cir. 2001); *Official Comm. of Unsecured Creditors v. Bank Group,* No. IP00-0496-C-H/G, 2001 WL 899637 (S.D. Ind. July 5, 2001) (BA543062). Finally, there is no evidence in this case that the recovery by Mellon would directly benefit any other entity than itself. For these reasons, the Court is not persuaded that the instant case should be likened to *In re Sweetwater.*

The Court has found that Mellon lacks standing to bring the instant action because it has failed to show that it may stand in the shoes of the Debtors and because it has failed to show that recovery in this case will benefit the

estates.[6] Therefore, the Bankruptcy Court's ruling that summary judgment in favor of GE and DC is appropriate should be **AFFIRMED**.

Having found that summary judgment in favor of GE and DC was proper, the Court declines Mellon's invitation to address the merits of its summary judgment motion.

IV. CONCLUSION

The Court has found that the Bankruptcy Court erred when it found that the Avoidance Claims at issue in this case were sold to the Purchasers in the asset sale, and therefore, the Bankruptcy Court lacked jurisdiction over the action. Therefore, the decision of the Bankruptcy Court that it lacked subject matter jurisdiction over the claims is **REVERSED**. However, the Court has also found that Mellon lacks standing to bring adversary proceedings against GE Supply Company and Dick Corporation because it failed to evidence that it could stand in the shoes of the Debtors and because it failed to show recovery would benefit the estates. Accordingly, the Bankruptcy Court's ruling that summary judgment in favor of GE Supply Company and Dick Corporation should be granted because Mellon lacks standing is **AFFIRMED**. Mellon's claims against GE Supply Company and Dick Corporation are dismissed without prejudice.

---

[6] The Defendants also argue, in the alternative, that the Debtors have abandoned these claims, therefore, Mellon lacks standing. Having found that Mellon lacks standing for other reasons, the Court will not reach the Defendants' third argument.

IT IS SO ORDERED this 9 day of May, 2003.

/s/ Larry J. McKinney
LARRY J. McKINNEY,
CHIEF JUDGE
United States District Court
Southern District of Indiana

Distribution attached.

Distributed to:

Melissa J. De Groff
DANN PECAR NEWMAN & KLEINMAN PC
One American Square Suite 2300
Indianapolis, IN 46282

Charleyne Gabriel
KUNZ & OPPERMAN
135 N. Pennsylvania Street, Suite 1750
Indianapolis, IN 46204-2456

Andrew P. Brozman
Jennifer C. DeMarco
CHADBOURNE & PARKE LLP
30 Rockefeller Plaza
New York, NY 10112

Martin J. Weis
DILWORTH PAXSON, LLP
3200 Mellon Bank Center
1735 Market Street
Philadelphia, PA 19103

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

In re: Qualitech Steel Corporation Qualitech Steel Holdings	Case No. 99-3364-AJM-11 Case No. 99-3363-AJM-11 Jointly Administered Under 99-3364-AJM-11
Mellon Bank, N.A. as Collateral Agent for the Prepetition Senior Lenders, on behalf of Qualitech Steel Corporation, Plaintiff, vs. Dick Corporation, Defendant.	Adversary Proceeding No. 00-296
Mellon Bank, N.A. as Collateral Agent for the Prepetition Senior Lenders, Plaintiff, vs. GE Supply Company Defendant.	Adversary Proceeding No. 00-298

FINDINGS OF FACT AND CONCLUSIONS OF LAW REGARDING SUMMARY JUDGMENT MOTIONS

The Plaintiff, Mellon Bank, N.A. as Collateral Agent for the Prepetition Senior Lenders, commenced separate adversary proceedings by filing their separate Adversary Complaints against the Defendants, General Electric

Supply ("GE") and Dick Corporation ("DC"), to avoid and recover for the estate under Bankruptcy Code Sections 547 and 550 certain alleged preferential transfers. On January 23, 2001, the Plaintiff, GE and DC all moved for summary judgment. The cross motions for summary judgment were heard on February 15, 2001, wherein the Plaintiff in both adversaries appeared by counsel Andrew Brozman and Jennifer DeMarco; Defendant GE appeared by counsel Charleyne Gabriel; Defendant DC appeared by counsel Martin Weis. At the conclusion of the hearing, the Court instructed the parties to submit their respective proposed findings and conclusions. After several agreed-to extensions, the parties filed their respective findings and conclusions on June 1, 2001. Pursuant to Federal Rule of Civil Procedure 52, made applicable to this proceeding by Bankruptcy Rule 7052, the Court enters the following Findings of Fact and Conclusions of Law.

Findings of Fact

1. On March 22, 1999, Qualitech Steel Corporation ("Qualitech" or "Debtor") and its parent company, Qualitech Steel Holdings Corp., filed for Chapter 11 relief in the United States Bankruptcy Court for the Southern District of Indiana. *See* DC Exhibit 1, ¶8.[1] Thereafter, Qualitech operated as a debtor in possession. *See* DC Exhibit 1, ¶8.

---

[1] References to "DC Exhibits" are to exhibits contained in Appendix Of Documents in Support Of Motion Of Dick Corporation for Summary Judgment.

2. Qualitech filed for Chapter 11 relief not to reorganize, but for the purpose of enhancing a sale of Qualitech's assets. *See* McIlvain Dec.[2], Ex. C, ¶5.

3. At the time of the filing of the bankruptcy case, Dick Corporation was still owed in excess of $7 million from Qualitech. *See* DC Exhibit 14, ¶6. At the time of the filing of the Bankruptcy Case, G.E. Supply was still owed in excess of $1,531,226.88 from Qualitech in unsecured debt. *See* Proof of Claim filed by G.E. Supply on 7/7/1999.

4. On May 13, 1999, this Court entered an Order ("the Final Financing Order") in the bankruptcy case approving the Debtor's financing arrangement with its prepetition lenders ("Prepetition Lenders") wherein the Court authorized the Debtors to incur postpetition financing pursuant to Section 364(d) which financing was secured by a senior priming lien on all of the Debtors' assets as set forth in detail in the postpetition credit agreement (the "DIP Financing"). In connection with the DIP Financing, the Court determined that the existing Prepetition Senior Lenders were entitled to adequate protection of their interests in the prepetition collateral, including existing cash collateral, for any diminution in value of the prepetition collateral, including without limitation, that resulting from the use of the cash collateral, the incurrence by the Debtors of postpetition financing secured by senior liens on the prepetition collateral

[2] References to "McIlvain Dec." are in the Declaration of J. Bradford McIlvain in Opposition to Mellon Bank's Motion for Summary Judgment.

and the use sale or lease of the prepetition collateral and the imposition of the automatic stay.

5. To that end and as adequate protection, the Court granted to the Prepetition Senior Lenders pursuant to the Final Financing Order a replacement lien (the "Replacement Lien") in all of the assets of the Debtor, including the proceeds (the "Avoidance Recovery Property") of avoidance claims arising under Sections 542, 544, 546, 547, 548, 549, 550, 551 or 553 of the Bankruptcy Code (the "Avoidance Claims"), and a superpriority administrative claim (the "Superpriority Claim") to the extent that the value of the prepetition collateral of the Prepetition Senior Lenders diminished following the Petition Date as the result of the DIP Financing.

6. Also in May, 1999, the Court entered an Order permitting Qualitech to auction its assets. *See* DC Exhibit 7, pp. 2-3. Therefore, on June 30, 1999 the Debtor conducted an auction of substantially all of the assets related or appurtenant to its iron carbide plant located in Corpus Christi, Texas (the "I/C Plant") and its special bar quality steel mill in Pittsboro, Indiana (the "SBQ Facility"). The end result of which was that Mellon, on behalf of the Prepetition Lenders, bid $180,000,000 of its lien and purchased substantially all of Qualitech's assets on behalf of designees of the Prepetition Lenders, Qualitech Steel SBQ, LLC and Qualitech Steel Iron Carbide Corporation. *See* DC Exhibit 7, pp. 2-3, and the sale was approved by this Court by order dated August 13, 1999 (the "Sale Order").

7. The Sale Order defines the property to be sold as the "Assets". The "Assets", in turn, consist of "all of the Debtors' right, title and interests in and to the Collateral

described by and contained in the Final Financing Order". See, footnote 2, page 4 of the Sale Order. The Final Financing Order, in turn, defines "Collateral" as that term was defined in Section 5.2 of the document titled "Credit Agreement" which was attached as Exhibit A to the Final Financing Order. *See* DC Exhibit 4, Ex. A, Sec. 5.2.

8. Section 5.2 of the Credit Agreement, in turn, defines the Collateral as including "all Avoidance Recovery Property and Avoidance Claims of each of the Borrower and the Parent," i.e. Qualitech Steel Corporation and Qualitech Steel Holdings Corporation.

9. "Avoidance Claims" are defined in the Credit Agreement as "Any claim of either of the Borrower or the Parent to avoid a transfer by either of the Borrower or the Parent under the Bankruptcy Code, including, without limitation, any claim for avoidance arising under sections 542, 544, 546, 547, 548, 549, 550, 551 or 553 of the Bankruptcy Code or otherwise."

10. Avoidance Recovery Property" is defined in the Credit Agreement as "Any property of either of the Borrower or the Parent that has been or could be recovered through the successful pursuit of an Avoidance Claim." *INDIANAPOLIS DIVISION.* at p. 4.

11. On August 25, 1999, the sale of the Debtors' "assets" (as defined in the Sale Order) to the Prepetition Lenders closed. The assets used in connection with the Debtor's SBQ Facility were transferred to Qualitech Steel SBQ LLC and the assets used in connection with the I/C Plant were transferred to Qualitech Steel Iron Carbide Corp. (together, the "Purchasers"). As is acknowledged by Debtor's counsel, though, as of January 28, 2001, and as a result of the sale, "All of Qualitech's assets have been sold

or transferred and there are presently no assets in the bankruptcy estate to distribute." McIlvain Dec., Ex. C, ¶5.

12. On November 3, 1999, following the sale of substantially all of the Debtor's assets to the Purchasers, the Official Committee of Unsecured Creditors (the "Committee") made a motion, in part, to determine the extent of the Replacement Lien granted to the Prepetition Senior Lenders in connection with the Final Financing Order and the rights of the Prepetition Senior Lenders (as Replacement Lien Holders) to the proceeds of Avoidance Claims. The Committee asserted that there was no diminution in the value of the prepetition collateral following the commencement of the Debtors' cases and, accordingly, that the Replacement Lien could not attach to any proceeds of Avoidance Claims.

13. The Committee's motion was opposed by, among others, Mellon which contended that Mellon, on behalf of the Prepetition Lenders had the right to all of the proceeds of the avoidance actions. *See* DC Exhibit 3. In one of its submissions opposing the relief, Mellon admitted that the proceeds of these actions exist solely for the benefit of the Prepetition Lenders:

> Other than to observe that the Committee's lawyers have been unsuccessful in coercing the Senior Lenders into paying their fees above and beyond the negotiated "carve-out," one wonders why the Committee has insisted on engaging this dispute now, in advance of any showing that there are preference recoveries to be pursued for the benefit of the estates. (Clearly, this would be necessary before the Court could authorize the expenditure of further fees by Committee counsel in pursuant of those recoveries. *See In re STN*

> *Enterprises,* 779 F.2d 901 (2d Cir. 1985).) The Committee has made no showing in this regard, otherwise leading one to conclude that its motion is not ripe for adjudication.)
>
> That being said, the Senior Lenders and the Debtors have undertaken such a preference analysis and recognize that there are recoveries to be pursued, *albeit for the benefit of the Senior Lenders under their replacement and other liens.*

DC Exhibit 3, p. 2, n.2. (emphasis added)

14. At a hearing on March 14, 2000 on the issue of the extent of the replacement lien, the Debtors provided evidence that "the value of the avoidance claims and the proceeds was less than Five Million Dollars ($5,000,000.00) in the aggregate." DC Exhibit 5, pp. 2-3.

15. As a result of the March 14, 2000 hearing this Court entered an Order Determining the Extent of the Prepetition Senior Lenders' Replacement Lien Pursuant to the Final Financing Order (the "Replacement Lien Order") which held that there was a diminution in the value of the collateral of the Prepetition Senior Lenders from the Petition Date to the Closing, as a result of the Debtor's use of the Prepetition Senior Lenders' cash collateral and the granting of the senior security interests and liens to the DIP Financing lenders, of not less than $30,000,000. This Court in the Replacement Lien Order specifically determined that the Replacement Lien "has attached to the assets of the Debtors comprising the Collateral, *including Avoidance Recovery Property, other than those assets transferred pursuant to the Sale Order.* . . . As a result, the extent of the Replacement Lien granted to the Prepetition Senior Lenders pursuant to the Final Financing Order in all Collateral, *including Avoidance Recovery*

Property, be and hereby is fixed in an amount of not less than $30,000,000." (Replacement Lien Order at decretal paragraphs 2 and 3) (emphasis added).

This Court ultimately denied the relief requested by the Committee.

16. In or about March, 2000, the Prepetition Lenders and the Debtors entered into a stipulation (the "Authorization Stipulation") proposing to assign and/or otherwise abandon the Debtors' avoidance actions to the banks. In response to objections raised to that stipulation, the Prepetition Lenders acknowledged that the purpose of the stipulation was for the Prepetition Lenders to recoup a small portion of their large losses in these cases from those who benefitted from avoidable transfers. *See* DC Exhibit 6, p. 2. In that filng, the Prepetition Lenders go on to provide an additional acknowledgment as to the value of the proposed actions:

> Concomitant to the determination of the Pre-Petition Senior Lenders' substantial replacement lien, the Debtors advised that, as a result of their investigation, they determined that there existed approximately $2,600,000 of potential recoveries for claims arising under Section 547 of the Bankruptcy Code. The Pre-Petition Senior Lenders believe the potential preference recoveries to exceed that amount but reasonably believe the amount to be significantly less than $30,000,000.

DC Exhibit 6, p.3, ¶4.

17. The Authorization Stipulation contained certain provisions designed to allow the Prepetition Lenders to monitor and oversee the prosecution of the Avoidance Claims on behalf of the estates with a modicum of control

from the Debtors and the Court. For example, the Authorization Stipulation authorized the Prepetition Lenders to settle any avoidance claims and a power of attorney to execute documents in the Debtors' names to effectuate any settlement, and required a proposed settlement of any Avoidance Claims to be subject to the provisions of Bankruptcy Rule 9019.

18. Likewise, the Authorization Stipulation obligated the Prepetition Senior Lenders regularly to file with the Court a report on the status of the actions commenced with respect to the Avoidance Claims. Finally, it provided that any Avoidance Claim that the Prepetition Senior Lenders elected not to pursue would be subject to further order of the Court to enable other parties in interests the opportunity to seek authorization to commence an action on behalf of the estates.

19. However, certain provisions also allowed the Prepetition Lenders to take action on their own. In particular, the Authorization Stipulation provides the Prepetition Lenders with the authority to collect all proceeds of avoidance claims, net of collection costs, including attorneys fees, in repayment of their replacement lien. *See* DC Exhibit 7, ¶C. The Authorized Stipulation provided that these net proceeds of the Avoidance Claims might be "subject to disbursement" (as opposed to required to be paid) to the Debtor's estate, *only if* the net proceeds exceeded $30 million (e.g. the amount of the Replacement Lien). DC Exhibit 7, p.3, ¶C; and, until such time as the net proceeds in the avoidance claims exceed $30 million, the Authorization Stipulation provided that the automatic stay was modified to give the Prepetition Lenders the right to collect the net proceeds and apply these moneys to their debt. *See* DC Exhibit 7, p.3, ¶¶C, F.

(2)

No. 03-1252

Supreme Court, U.S.
FILED
APR - 1 2004
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

DICK CORPORATION and GE SUPPLY COMPANY,

Petitioners,

v.

MELLON BANK, N.A.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF IN OPPOSITION

ANDREW P. BROZMAN
Counsel of Record
JENNIFER C. DEMARCO
CHADBOURNE & PARKE LLP
30 Rockefeller Plaza
New York, NY 10112
(212) 408-5100

Attorneys for Respondent

186741

CP
BEST AVAILABLE COPY

COUNTERSTATEMENT OF QUESTION PRESENTED

1. May a "trustee" in a chapter 11 case recover avoidable transfers "for the benefit of the estate" under Section 550(a) of the Bankruptcy Code when the proceeds of those recoveries will be distributed by the estate to a single class of creditors in accordance with the priorities of the Bankruptcy Code and prior, non-appealable orders of the court?

The questions presented by the Petitioners are either: (a) concluded finally by the prior decision of the Seventh Circuit, *In re Qualitech Steel Corp.*, 276 F.3d 245 (7th Cir. 2001) or other final, non-appealable orders that determined, for better or for worse, that the Respondent properly stands in the shoes of the "trustee"; or (b) comprise factual disagreements with prior decisions of the lower courts as to whether benefits to the estate had been conferred by the Respondent. In either event, none of the questions posed by the Petitioners is either the subject of the decision below or preserved for further review.

CORPORATE DISCLOSURE STATEMENT

In accordance with United States Supreme Court Rule 29.6, Respondent makes the following disclosures:

Mellon Bank, N.A. is the collateral agent for the following prepetition senior lenders to Qualitech Steel Corporation:

Bank Austria Creditanstalt
Bank of America
Banque Nationale de Paris (nka BNP Paribas)
Comerica Bank
Harris Trust and Savings Bank
Kreditanstalt für Wiederaufbau
LaSalle Bank, N.A.
Mellon Bank, N.A.
National City Bank, Indiana
The Sanwa Bank, Limited
Westdeutsche Landesbank Girozentrale
Keybank Corporation
Credit Suisse/First Boston
GATX Capital Corp.

Mellon Bank, N.A. is a subsidiary of Mellon Financial Corporation, which is publicly traded.

TABLE OF CONTENTS

	Page
Counterstatement of Question Presented	i
Corporate Disclosure Statement	ii
Table of Contents	iii
Table of Cited Authorities	iv
Statement of the Case	1
1. The Decision of the Seventh Circuit	1
2. The Factual Context	2
Reasons for Denying the Petition for a Writ	7
I. There Is No Conflict Between *Qualitech II* and the Precise Terms of Section 550(a) of the Bankruptcy Code. As a Result, There Is No Fundamental Issue of Which this Court Must Take Cognizance.	8
II. For the Same Reasons, the Decision Does Not Conflict With, or Presume the Resolution of the Issue Reserved in, *Hartford Underwriters*.	10
III. *Qualitech II* Works No Variance in the Fundamental Principles Upon Which Avoidance Claims Are Predicated.	12
Conclusion	15

TABLE OF CITED AUTHORITIES

Page

Cases

Canadian Pac. Forest Prods. Ltd. v. J.D. Irving, Ltd. (In re Gibson Group), 66 F.3d 1436 (6th Cir. 1995) 11

Commodore Electronics Ltd. v. Gould (In re Commodore Int'l Ltd.), 262 F.3d 96 (2d Cir. 2001) 11

Hartford Underwriters Inc. Co. v. Union Planters Bank, N.A., 530 U.S. 1 (2000) 10, 11, 12

Mellon Bank, N.A. v. Dick Corp., 351 F.3d 290 (7th Cir. 2003) ..... *passim*

Official Committee of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548 (3d Cir. 2003) 11-12

P.A. Bergner & Co. v. Bank One, Milwaukee, N.A. (In re P.A. Bergner & Co.), 140 F.3d 1111 (7th Cir. 1998) 9-10

In re Qualitech Steel Corp., 276 F.3d 245 (7th Cir. 2001) ..... *passim*

Cited Authorities

Page

Statutes

11 U.S.C. § 364 3

11 U.S.C. § 502 7

11 U.S.C. § 503 7

11 U.S.C. § 506 .....4, 10, 11, 12

11 U.S.C. § 510 7

11 U.S.C. § 550 ..... *passim*

11 U.S.C. § 1129 7

STATEMENT OF THE CASE

1. *The Decision of the Seventh Circuit*

The sole issue resolved by the Court of Appeals in *Mellon Bank, N.A. v. Dick Corp.*, 351 F.3d 290, 291 (7th Cir. 2003) ("*Qualitech II*") was that a suit brought on behalf of an estate satisfied the Section 550(a) rubric that avoidance claims be recovered "for the benefit of the estate" even though, by reason of statutory priorities, the proceeds would be distributed only to one class of creditors.

The Seventh Circuit did not adjudicate the propriety of the bankruptcy judge's decision to afford the Senior Lenders a replacement lien in avoidance recoveries pursuant to its order dated May 13, 1999, approving debtor-in-possession financing (the "Financing Order"). The Petitioners never appealed from any provision of the Financing Order and the Court of Appeals already had held the time of the Official Committee of Unsecured Creditors to do so later to be "long past." *In re Qualitech Steel Corp.*, 276 F.3d 245, 248 (7th Cir. 2001) ("*Qualitech I*").

The Court of Appeals similarly was not called upon to hold that the bankruptcy court properly afforded Mellon Bank, N.A., as collateral agent for the Senior Lenders ("Mellon Bank"), the status of a "trustee" to pursue avoidance claims on behalf of the estate by reason of its authorization order dated June 8, 2000 and its replacement lien order dated March 14, 2000. No party appealed the former and the latter was appealed and decided finally and adversely to the Petitioners' position in *Qualitech I*.

2. *The Factual Context*

"Qualitech Steel Corporation had a short, unhappy, and expensive life." *Qualitech I*, 276 F.3d at 246. Qualitech Steel Corporation ("Qualitech") was a start up venture designed to construct a state of the art, special bar quality steel "mini-mill" and a new technology iron carbide plant, the product of which was meant to fuel the mini-mill at reduced costs. The company was capitalized by a substantial amount of private equity, institutional and governmental-sponsored bonds and a senior secured credit facility extended by a group of lenders (the "Senior Lenders") as to which Mellon Bank served as collateral agent. The total capitalization approximated $400 million.

Before either the mini-mill or the iron carbide plant were complete and operational, Qualitech had exhausted its capital resources. Indeed, just prior to its formal descent into chapter 11, Qualitech was experiencing cash losses of approximately $10 million a month. *Qualitech I* at 246; App. 2. Management, unable to persuade any component of the capital structure to infuse more funds, determined that a chapter 11 filing, in which the business operations, limited as they were, could be preserved and sold as a going concern was in the best interests of the Qualitech commonweal. *Qualitech I* at 246.

To finance its loss operations until a sale in chapter 11, Qualitech and its parent company affiliated debtor (together, the "Debtors") negotiated with a sub-group of the Senior Lenders (the "DIP Lenders") debtor-in-possession financing in an amount of $30 million (the "DIP Facility"), the net amount of funds management estimated Qualitech would lose

before a sale could be effected.[1] *See Qualitech I* at 246-247; App. 11. Given the condition of the borrower, the DIP Lenders agreed to the DIP Facility only on the condition that they receive a "super priority" lien and administrative claim that subordinated the existing liens of the Senior Lenders on all of the assets of the Debtors. *Qualitech I* at 247; App. 11-12. Because it was apparent that the DIP Facility would create no new assets but only fund losses, the Senior Lenders were unwilling to consent to the "priming" lien of the DIP Lenders unless they were afforded "adequate protection" against any diminution of the value of their pre-petition collateral resulting from the subordination of their liens. App. 2-3.

By means of the Financing Order, the bankruptcy court both approved the DIP Facility under section 364(d)(1) of the Bankruptcy Code and granted the Senior Lenders adequate protection by means of "Replacement Liens", junior only to the liens of the DIP Lenders, on, among other things, the Debtors' post-petition assets, including on Avoidance Recovery Property. *See Qualitech I* at 247; App. 12-14. The bankruptcy court made a number of specific factual findings in support of the Financing Order, including that it is "*necessary and is in the best interests of the Debtors.*"[2] C.A. App. 51. Neither the Petitioners nor any other party-in-interest appealed the Financing Order or sought to stay it. *Qualitech I*, 276 F.3d at 247.

---

1. While the Petitioners assert that the post-petition financing arrangements were with the "Prepetition Senior Lenders" (Petition at 11), the DIP Lenders were comprised of some, but not all, of the Senior Lenders. *Qualitech I* at 247.

2. Contradicting Petitioners' assertion that the purpose of the DIP Facility was to allow the Debtors to continue to a sale "all for the benefit of these secured creditors." (Petition at 4).

By its terms, the DIP Facility was linked to a timely sale of the Debtors' business assets as a going concern. C.A. App. 107. The entry of the Financing Order evidenced the bankruptcy court's approval of the estates' business judgment that the component parts of the DIP Facility, the loss funding, the subordination of the Senior Lenders' liens, the Replacement Lien and the going concern sale, were in the best interests of the estates and their creditors. C.A. App. 43-71.

A going concern sale of the assets appurtenant to the operating businesses of the mini-mill and the iron carbide plant was put in motion by the Debtors and engendered great contest among factions of the unsecured creditors. Ultimately, that contest was resolved by the entry of an order of the bankruptcy court authorizing an auction of the business assets. App. 60. Insufficient bidding at the auction caused the Senior Lenders to "credit bid" $180 million of their approximately $265 million (plus other accrued costs and expenses) in claims. *Qualitech I* at 246-247. Of the $180 million, $30 million was used to retire the obligations to the DIP Lenders. *Qualitech I* at 247. The balance of the Senior Lenders' claims were deemed unsecured by operation of section 506(a) of the Bankruptcy Code, except to the extent of the value of the Replacement Liens. *See Qualitech I* at 247. The sale was approved (by the "Sale Order" dated August 13, 1999) and the Debtors' operating business assets were sold to entities designated by the Senior Lenders.[3] App. 15-16.

---

3. Contradicting Petitioners' unsupported assertion that "Mellon, on behalf of the Prepetition Lenders, . . . purchased substantially all of the Debtors' assets." (Petition at 5).

It was only by reason of the DIP Facility and its component Replacement Liens and embedded sale process that the Debtors were able to effect a going concern sale to the benefit of numerous estate constituencies, including most pertinently the unsecured creditors, they having received as a result the additional benefit in the form of a distribution of a $7.5 million note. App. 5.

After the sale, the Official Committee of Unsecured Creditors (the "Committee") sought an order from the bankruptcy court: (1) determining rights to the proceeds of Avoidance Recovery Property, asserting that the Replacement Lien did not attach to the Avoidance Recovery Property because, among other things, the collateral of the Senior Lenders had increased in value; and (2) permitting the Committee to prosecute avoidance claims on behalf of the estate or to convert the cases to ones under chapter 7. App. 16. Mellon Bank adduced evidence at the hearing establishing the diminution in value of its collateral. *See Qualitech I.* As the estimate of prospective Avoidance Recovery Property did not exceed that diminution in value, Mellon Bank also urged that neither the Committee nor a chapter 7 trustee had a realistic stake in the proceeds of those actions and, accordingly, were not the best parties to pursue them vigorously.

By order dated March 14, 2000 (the "Replacement Lien Order"), the bankruptcy court denied the Committee's motion and found the value of the Senior Lenders' collateral to have diminished by no less than $30 million as a consequence of the DIP Facility and the Debtors' loss operations. *See Qualitech I*; App. 2-3. The court also found that the Replacement Liens would attach to, among other things, the Avoidance Recovery Property, and fixed the liens

in an amount of not less than $30 million. App. 2-3. It was the Committee's appeal from this order that resulted in the decision in *Qualitech I.*

Prior to the date of the *Qualitech I* decision, Mellon Bank, with the stipulated consent of the Debtors, sought authority from the bankruptcy court to prosecute actions for Avoidance Recovery Property in the name of and on behalf of the Debtors' estates. The court granted that authority by order dated June 8, 2000 (the "Authorization Order") which, among other things, placed Mellon Bank in the shoes of the Debtors for the express purpose of prosecuting the actions and to recover them for the Debtors' estates.[4] C.A. App. 402. That order neither disabled the Debtors from bringing actions nor prevented Mellon Bank from eschewing the pursuit of certain actions. C.A. App. 399-404. The Authorization Order was entered by the court and has become a "final order" from which no party had appealed.

The actions against the Petitioners (the "Dick/GE Adversary") were two of many actions commenced by Mellon Bank with respect to Avoidance Recovery Property. They sought recovery of an aggregate of about $900 thousand. (Other actions included one ultimately settled before the date of the bankruptcy court's decision in the Dick/GE Adversary in the amount of $15 million and approved by the bankruptcy court by order dated April 27, 2001 as being "*in the best interests of the estates*." C.A. App. 664.)

---

4. Petitioners' assertion that the Authorization Order proposed to "assign" avoidance actions to the Senior Lenders is contrary to the provisions of the Authorization Order which contained no assignment. C.A. App. 399-404.

Incongruously, the bankruptcy court thereafter was persuaded by the Petitioners to dismiss the Dick/GE Adversary on the grounds that: (1) the Sale Order entered two years previously had deprived the court of subject matter jurisdiction in that it "sold" the Avoidance Recovery Actions to the purchaser of the business assets; and (2) that the recovery by Mellon Bank in the name of and on behalf of the estate did not constitute a recovery within the contemplation of section 550(a). On appeal by Mellon Bank, the district court reversed the first ground and sustained the second. The Court of Appeals overturned the district court finding no merit in either ground.

REASONS FOR DENYING THE PETITION FOR A WRIT

The issues Petitioners urge for review by this Court are ones that the Seventh Circuit did not address in *Qualitech II*. Their quarrel is not with that decision, which is wholly unremarkable in its holding, but with the variety of final orders and the earlier *Qualitech I* decision no longer susceptible to any review and outside the ambit of this petition.

All that is capable of contest here is the Court of Appeals' affirmation of prior decisional law, albeit it in the factually complex setting of the Qualitech failure. *Qualitech II* no more than agrees with the plain wording of section 550(a) that avoided transfers must be recovered "for the benefit of the estate," if at all. In posing the questions it uses to frame its decision, it does no more than state the obvious differentiation between *recovery by the estate* and *distribution by the estate* pursuant to statutory command or contractual enforcement. Each is required by the Bankruptcy Code (*compare* section 550 with sections 502, 503, 510(a) and 1129, for example)

but neither defines the other. All the Seventh Circuit held, in other words, was that one cannot define a recovery "by the estate" to vary by reason of which estate components may receive the proceeds under the statutory distributive scheme. The Court of Appeals specifically held (*Qualitech II,* 351 F.3d at 293 (App. 6)):

> Lest this way of resolving the issue be taken to assume that section 550(a) requires that some benefit flow to unsecured creditors, we add that the statute does not say this. Section 550(a) speaks of benefit to *the estate* — which in bankruptcy parlance denotes the set of all potentially interested parties — rather than to any particular class of creditors. What happens to recoveries that reach the estate's coffers depends on contractual and statutory requirements.

Because this holding perfectly comports with the language of section 550(a) and is not in conflict with the decisions of this Court or those of any other circuit, the issue is not appropriate for discretionary review.

I. There Is No Conflict Between *Qualitech II* and the Precise Terms of Section 550(a) of the Bankruptcy Code. As a Result, There Is No Fundamental Issue of Which this Court Must Take Cognizance.

The Petitioners are disgruntled because the bankruptcy court in the Financing Order, the Replacement Lien Order and the Authorization Order decided to give the Senior Lenders a lien on Avoidance Recovery Property and authority to pursue its recovery "in the name and for the benefit of the

estates." Those orders, and, as to the Replacement Lien Order, the decision in *Qualitech I* affirming it, are in the distant, non-appealable past.

The Petitioners incorrectly assert for their *certiorari* predicate that *Qualitech II* does violence to the plain language of section 550(a). That language — "the trustee may recover for the benefit of the estate" — embraces two distinct concepts: (1) the "trustee" may recover; and (2) for the benefit of "the estate." Yet, *Qualitech II* addresses only the latter portion, and does so in full precision with the language of the statute. It is the first part, the assertion by the Petitioners that a "secured creditor" is pursuing the recovery (*see, e.g.* Petition, Questions Presented Nos. 1 and 2), with which the Petitioners really take issue. But that issue previously was litigated to finality (either in the final bankruptcy court orders or by *Qualitech I*) and formed part of the immutable legal landscape providing background to the *Qualitech II* decision.

By reason of the historical inheritance of the position of "trustee" by Mellon Bank, an issue not involved in this appeal, the *Qualitech II* decision did not and could not pass upon the wisdom of that court-created lineage. Upon that historical predicate, the only question the decision addressed was "benefit to the estate" and the Court of Appeals neither ignored nor implied other terms to that statutory language. It merely recognized what other courts before it had done, namely, that the estate embraces a broad amalgam of interests, the rights of each to the distributions by the estate being dictated and varied by statute and contract. *P.A. Bergner &*

Co. v. Bank One, Milwaukee, N.A. (In re P.A. Bergner & Co.), 140 F.3d 1111, 1118 (7th Cir. 1998).[5]

II. For the Same Reasons, the Decision Does Not Conflict With, or Presume the Resolution of the Issue Reserved in, *Hartford Underwriters.*

This Court's decision in *Hartford Underwriters Inc. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) very clearly determined: (1) that the judiciary is obliged to apply "plain" statutory language in accordance with its "precise terms;" and (2) the plain language of section 506(c) to permit only "the trustee" to surcharge collateral. Neither determination is implicated, let alone derogated, by the *Qualitech II* decision.

The Court of Appeals neither tortured nor imported implicit text into the "plain" language of section 550(a) when it determined that a recovery on behalf and into the "coffers" of the estate was "for the benefit of the estate." Rather, *it specifically declined to vary the plain language at the behest of the Petitioners* by refusing to substitute "unsecured creditors" where the statute read "estate." *Qualitech II*, 351 F.3d at 293 (App. 6).

---

5. Petitioners' suggestion that their petition should be granted because *Qualitech II* conflicts "with decisions of bankruptcy courts nationwide" (Petition at 11), is neither accurate nor compelling. Each of the few bankruptcy court cases collected at page 10 of the Petition involved either a purported transfer of the avoidance claims *to a party outside of the estate* or was an element of the creditor's pre-petition security interest. Even if pertinent, no circuit court has adopted the views in conflict with the holding of *Qualitech II*. At best, therefore, this issue is not yet ripe for consideration on this Petition.

So, too, did the circuit court not visit, even by analogy, the second determination reached in *Hartford Underwriters*, as the facts presented Mellon Bank already inserted into the shoes of the trustee by prior orders and decisions from which Petitioners took no appeal and by which they, and the circuit court, were bound. For that reason, in no sense did the Court of Appeals hold in *Qualitech II*, that, for purposes of section 550(a), "trustee" includes "or its authorized representative."[6]

Finally, the Seventh Circuit found it unnecessary to address the issue reserved in the footnote of the *Hartford Underwriters* decision, 530 U.S. at 13 n.5. The Court of Appeals specifically declined to consider whether derivative-type actions to recover avoidance property may be pursued over the opposition of the "trustee" or other estate fiduciaries. *Qualitech II*, 351 F.3d at 292 (App. 4). Indeed, it answered a settled question, namely, whether or not Mellon Bank got there improvidently, on this appeal it *was* the "trustee" pursuing the recoveries in the name and for the benefit of the estate.

In all events, the open question left by this Court in footnote 5 relates to the power of a bankruptcy court to substitute a party other than the trustee to effect section 506(c) surcharge claims. As noted by the Third Circuit in the *en banc Cybergenics* decision, *cf.*, *Official Committee of*

---

6. For the reasons expressed in many opinions of the various circuit courts, Mellon Bank agrees that such a reading of the statutory text is appropriate and desirable. *See Commodore Electronics Ltd. v. Gould (In re Commodore Int'l Ltd.)*, 262 F.3d 96, 100 (2d Cir. 2001); *Canadian Pac. Forest Prods. Ltd. v. J.D. Irving, Ltd. (In re Gibson Group)*, 66 F.3d 1436, 1446 (6th Cir. 1995). That being said, *Qualitech II* is not the case, if one is needed at all, to present the issue to this Court.

Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 559-70 (3d Cir. 2003) (*en banc*), the resolution of the section 506(a) question does not necessarily resolve that issue in relation to avoidance recoveries. Certainly, one would not reach out to the fact specific and somewhat *sui generis Qualitech* cases for the medium to alter the widely adopted current practice as it relates to avoidance actions.

Curiously, the Petitioners seem to concede that *Hartford Underwriters* has no application here unless "Mellon's assertion of the preference case was for its own benefit, ..." (Petition at 12-3.) Because that facially was not the case, the Petitioners elide the lack of conflict with *Hartford Underwriters* by suggesting the Court take on the *Cybergenics* decision. (*Id.* at 13.) However appealing that invitation may be in other circumstances, here *Qualitech II* placed no reliance on, nor would it be undermined by the reversal of, *Cybergenics* as the Seventh Circuit had no need to address more than the "benefit of the estate" issue.

III. *Qualitech II* Works No Variance in the Fundamental Principles Upon Which Avoidance Claims Are Predicated.

The Petitioners posit that the Seventh Circuit's decision will upset fundamental bankruptcy economics because preference recoveries are grounded upon the principle of equality of distribution among creditors of like priority. The predicate for this fear is not grounded in either the facts or legal holdings of *Qualitech II*, however as that decision neither frustrated the equality among unsecured creditors nor authorized any scheme by which unsecured creditors in future cases could be victimized.

Because there is nothing inherently improper about a debtor paying a just debt to a creditor, the law has always recognized that a preference may not be recovered for the benefit of "equity" or the original debtor-transferor. That would vitiate creditor equality and promote an unwarranted windfall to the equity. But, this is a very different proposition than the recovery by an estate for distribution to creditors of that estate, even if those distributees are not general unsecured creditors. Were it otherwise, the preferred creditors would retain a windfall, an inequality of distribution in comparison to the non-preferred creditors. The fact that the proceeds of those recoveries will be distributed by the estate to creditors with a more senior claim to them neither implicates inequality among creditors with *like priority* nor does it offend the policy of against an equity windfall.

The decision of the Court of Appeals left these principles wholly undisturbed and, because it determined that the recovery by the estate and subsequent distribution to creditors in accordance with statutory priority was proper, actually preserved equality of distribution among general unsecured creditors *inter se*.

The Petitioners' further suggestion that *Qualitech II* fosters or approves of lender liens on avoidance recovery property and, accordingly, ought be nipped in the bud before future damage to fundamental principles can be wreaked, is nowhere found in the decision. But, as early as two years prior in *Qualitech I*, the Court of Appeals observed that, whatever the wisdom of the avoidance recovery lien in the Financing Order, the Financing Order was entered in 1999 and was not contested by appeal or stay. Accordingly, the Seventh Circuit considered that issue foreclosed from its

consideration before the *Qualitech I* decision.[7] It certainly did not revive it for its holding in *Qualitech II*, other than to recognize that the bankruptcy court granted the Replacement Liens on Avoidance Recovery Property because it found it to be to the benefit of the estates to do so. *Qualitech II*, 351 F.3d at 293 (App. 4-5).

To the extent the Petitioners take issue with the idea that bankruptcy judges may impose DIP financing liens on avoidance recovery property (*see* Petition at 16-7 and App. 89-111), their fight is neither here nor with this Respondent. To the extent the Petitioners take issue with the finding that the DIP Facility, and its component Replacement Liens and embedded sale, benefited the estate, that issue of fact was determined by the bankruptcy court in 1999 upon an evidentiary record and in a final order from which no one appealed.

---

7. The court said:

> The only other assets in sight were the proceeds of preference-recovery actions (also known as avoidance actions). After notice and a hearing, the bankruptcy court approved debtor-in-possession (DIP) financing of $30 million, with super-security and an award of replacement security to the senior lenders, to the extent that this was necessary to maintain their financial position. No one appealed or sought a stay.
>
> * * *
>
> Perhaps the authorization of the DIP financing and the associated use of preference-recovery proceeds for "adequate security" was imprudent; . . . . But the time to make this point is long past. The bankruptcy judge *did* authorize financing with additional security to the original lenders.

Qualitech I, 276 F.3d at 247, 248 (emphasis in original).

CONCLUSION

The petition for a writ of certiorari should be denied as it raises neither a conflict with existing decisions of this Court, a conflict among the courts of appeal, nor an issue of fundamental significance to the bankruptcy laws.

Respectfully submitted,

ANDREW P. BROZMAN
Counsel of Record
JENNIFER C. DEMARCO
CHADBOURNE & PARKE LLP
30 Rockefeller Plaza
New York, NY 10112
(212) 408-5100

Attorneys for Respondent

20. Although the Authorization Stipulation did not prevent or prohibit the Debtors from commencing any Avoidance Claim on their own behalf, it was recited in the Authorization Stipulation that the Debtors decided not to bring the avoidance action because they "determined that there is no equity in the Avoidance Claim for the Debtors or their Chapter 11 estates. *See* DC Exhibit 7 at 3.

21. The Court approved the Authorization Stipulation, after notice and hearing, on June 8, 2000.

22. On or about June 29, 2000 Mellon commenced five avoidance actions in the Court seeking preference recoveries under Bankruptcy Code Sections 547, 548 and 550 in the approximate amount of $1,781,000. *See* DC Exhibit 9. Included in these five actions is adversary no. 00-296 brought by Mellon Bank against Dick Corporation seeking recovery of alleged preferential transfers in the amount of $550,000. *See* DC Exhibit 9. Also included in these five actions is adversary no. 00-298 brought by Mellon Bank against G.E. Supply seeking recovery of alleged preterential transfers in the amount of $344,349.65. *See* DC Exhibit 9.

23. On or about August 9, 2000, Mellon commenced an additional proceeding against Mitsubishi International Corporation seeking a recovery of approximately $13.5 million. *See* DC Exhibit 9.

24. At the February 15th oral argument on the cross motions for summary judgment, counsel for Mellon admitted that the avoidance actions will not exceed 30 million dollars, thus preventing the estate from receiving any proceeds of the preference actions.

25 The Debtor's counsel's sole remaining task is to dismiss the bankruptcy petition after all remaining adversary proceedings have been completed. *See* McIlvain Dec., Exh. C, ¶¶ 5, 10. These adversary proceedings "involve disputes *among creditors over preferences,* warranties, cure payments and liens . . ." and Qualitech has no interest in these proceedings. McIlvain Dec., Exh. C, ¶¶ 10, 11 (emphasis added).

Conclusions of Law

The Defendants maintain that Mellon cannot bring the Avoidance Actions because the Avoidance Claims were part of the collateral that was included in the "Assets" that were sold on August 13, 1999. Consequently, the dispute here is between non-debtors which does not involve property of the Debtors' estates and therefore the Bankruptcy Court does not have subject matter jurisdiction over these actions.

In the alternative, the Defendants argue that, even if the Avoidance Claims were still property of the Debtors' estates, Mellon nevertheless lacks standing to bring these actions since only a trustee or debtor in possession is statutorily authorized to pursue such claims.

Finally, the Defendants argue that Mellon has no standing to pursue the Avoidance Actions because even the maximum potential recovery will not approach $30,000,000 (the amount of the Replacement Lien, to which the Avoidance Recovery Property will first be applied) and therefore, there will be no "benefit to the estate" as set forth in Bankruptcy Code §550.

Jurisdiction of the Bankruptcy Courts

1. The district courts have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11. *28 U.S.C. Section 1334(b).* Claims arising under, among other sections of the Bankruptcy Code, Section 547 are civil proceedings arising under title 11. *See, Wood v. Wood (In re Wood),* 825 F.2d 90, 97 (5th Cir. 1987).

2. Claims under Section 547 of the Bankruptcy Code are "core proceedings" within the contemplation of 28 U.S.C. Section 157(b). *Fleet Bank, N.A. v. Tierney, Kalis & Lucas (In re Patriot Ill. Corp.),* 181 B.R. 56, 60 (Bankr. C.D. III. 1994); *Narowetz Mechanical Contractors, Inc. v. Economy Mechanical Indus., Inc. (In re Narowetz Mechanical Contractors, Inc.),* 99 B.R. 850, 856 (N.D. III. 1989), and bankruptcy courts have jurisdiction to enter appropriate orders and judgments in such cases pursuant to 28 U.S.C. Section 158.

Summary Judgment Standard

3. Rule 56(c) of the Federal Rules of Civil Procedure provides that summary judgment is appropriate if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and the moving party is entitled to judgement as a matter of law." Fed. R. Civ. P.56(c).

4. The party moving for summary judgment bears the initial burden of demonstrating the basis for its motion, and identifying those portions of the "pleadings, depositions, answers to interrogatories, and admission on file, together with the affidavits if any," which demonstrates

the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett,* 477 U.S. 317, 322 (1986).

5. Once the moving party has filed a properly supported motion, the burden shifts to the nonmoving party to "set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e).

6. To determine whether summary judgment is appropriate, the Court must determine whether any genuine issue of material facts exists. An issue is "material" only if the dispute might affect the outcome of the suit under the governing law." *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248, (1986).

7. An issue is "genuine" only if the evidence is such "that a reasonable jury could return a verdict for the nonmoving party." *Anderson,* 477 U.S. at 248.

Property of the Estate –
Subject Matter Jurisdiction

8. Subject matter jurisdiction cannot be waived and may be contested by a party or raised *sua sponte* at any point in the proceeding. *Levin v. Attorney Registration and Disciplinary Commission of the Supreme Court of Illinois,* 74 F.3d 763, 766 (7th Cir. 1996) *cert. denied.*

9. The jurisdiction of the bankruptcy courts is derivative; it flows from the statutory grant of jurisdiction to the district courts. *In re K & L, Ltd.*, 741 F.2d 1023, 1028 (7th Cir. 1984). Thus, as set forth in 28 U.S.C. §157, a bankruptcy court's jurisdiction includes the power to adjudicate proceedings "arising in", "arising under" or "related to" a case under title 11. *Zerand-Bernal, Group,*

Inc. v. Cox, 23 F.3d 159, 161 (7th Cir. 1994); *In the Matter of Fedpak Systems, Inc.,* 80 F.3d 207, 213 (7th Cir. 1995).

10. A broad interpretation of the language in 28 U.S.C. §157 allows a bankruptcy court to have "related to" jurisdiction over a proceeding whenever the proceeding "could conceivably have any effect on the [bankruptcy] estate". *Pacor, Inc. v. Higgins,* 743 F.2d 984, 994 (3rd Cir. 1984).

11. The Seventh Circuit's view of a bankruptcy court's jurisdiction is a bit more limited: a case is "related" to a bankruptcy when the dispute "affects the amount of property for distribution [i.e. the debtor's estate] or the allocation of property among creditors". "Bankruptcy court jurisdiction does not follow . . . property [that is sold]"; rather, its jurisdiction "lapses when property leaves the estate", *Elscint, Inc. v. First Wisconsin Financial Corp.* (In the Matter of Xonics, Inc.), 813 F.2d 127, 131 (7th Cir. 1987). *Fedpak,* 80 F.3d at 214. Therefore, a bankruptcy court does not have jurisdiction over an internecine conflict between two creditors, once all disputes about their stakes in the bankrupt's property have been resolved. *Xonics,* 813 F.2d at 131.

12. A proceeding where the property at issue was no longer part of the bankruptcy estate and a determination of rights to such property would not affect any dispute by creditors over property that *was* part of the estate was dismissed because it did not fall within the bankruptcy court's "related to" jurisdiction under 28 U.S.C. §157(a) and §1334(b). *Fedpak,* 80 F.3d at 213.[3]

---

[3] In *Fedpak,* the Bankruptcy Court determined that a certain pre-petition agreement with respect to the debtor's manufacture of frozen

(Continued on following page)

13. To determine here whether the property which was sold on August 13, 1999 (and therefore left the estate) includes the property which is the subject of the adversary proceedings here (i.e. recovery from preference claims of the debtor), one need look no further than the Sale Order and the Final Financing Order. The Sale Order defines the property that was sold to Qualitech Steel SBQ, LLC and Qualitech Steel Iron Carbide Corporation, the designees of the Prepetition Lenders, as "Assets" which, in turn were defined in a footnote as "all of the Debtors' right, title and interests in and to the Collateral described by and contained in the Final Financing Order". The Final Financing Order and the Credit Agreement attached thereto define "Collateral" to include "Avoidance Claims", which are further defined as "any claim either of the Borrower (Qualitech Steel Corporation) or the Parent (Qualitech Steel Holdings Corp.) to avoid a transfer by either of the Borrower or the Parent under the Bankruptcy Code, including, without limitation, any claim for avoidance . . .

---

yogurt dispensing machines was valid. In enforcing the agreement, the Bankruptcy Court determined that the nondebtor party to the agreement (Jones) was entitled to the patent and know-how license to manufacture the machines. Later, the debtor-in-possession sold its assets, including its intellectual property rights, to Polar Express. Thereafter the debtor-in-possession, at the request of Polar Express, sought clarification from the Bankruptcy Court with respect to its earlier findings, and the respective rights of Polar Express and Jones in the intellectual property. The Bankruptcy Court issued its "clarification order", but the District Court on appeal, and the Seventh Circuit Court of Appeals affirming, determined that, because the relief sought was with respect to property (i.e. the intellectual property) that had been sold, that property "passed outside of [the] court's control when [it] was sold . . . " and therefore, "the bankruptcy court [has] no jurisdiction to determine rights to the property". *Fedpak*, 80 F.3d at 214-215.

under sections . . . 547, 548 . . . 550 . . . of the Bankruptcy Code".

14. It is clear from the plain collective language of the Sale Order, the Final Financing Order, and the Credit Agreement, (all of which were drafted by the Prepetition Lenders' counsel) that the avoidance claims which are the subject matter of these adversaries were among the assets sold in August, 1999, and hence, once sold, this court's jurisdiction lapsed. A determination as to these avoidance claims which are no longer property of the estate will not affect the rights of any creditors with respect to property that still remains within the estate. The relief sought by the Plaintiff does not fall within this court's "related to" jurisdiction under 28 U.S.C: §157(a) and §1334(b), and therefore, the Court concludes that summary judgment in favor of the Defendants is appropriate.

Standing

15. Even if this Court were to conclude that the avoidance claims were not among the assets that were sold in August, 1999, and hence, were still property of the estate over which this court could exercise its subject matter jurisdiction, other obstacles prevent the Plaintiff from pursuing those claims in this court.

16. Sections 547 and 548 of the Bankruptcy Code give the trustee the power to bring preference and avoidance actions. Section 1107(a) gives the debtor-in-possession similar power. 11 U.S.C. §§ 547, 548 and 1107(a). The purpose behind consolidating in the trustee or the debtor in possession the singular power to pursue avoidance claims on behalf of the estate arises both because: the Bankruptcy Code envisions the broad consolidation of all

tangible and intangible property in which the creditors as a whole have an interest as "property of the estate"; and it is necessary to avoid a loss of orderly process through the individual pursuit of claims by commonly aggrieved creditors. *Cf. In re Carbide Cutoff, Inc.* 703 F.2d 259, 264 (7th Cir. 1983).

17. Additional statutory authority exists that allows one other than a trustee or a debtor in possession to pursue a preference claim. Bankruptcy Code §1123(b)(3) provides that *a chapter 11 plan* may provide for the "settlement or adjustment of any claim or interest belonging to the debtor or to the estate" or "the retention and enforcement . . . by a *representative of the estate* appointed for such purpose, of any such claim or interest". (emphasis added).

18. Even in the absence of statutory authority, many courts have found "an implied but qualified right" for *creditors' committees* to bring adversary proceedings. *In re STN Enterprises, Inc.* 779 F.2d 901, 904 (2nd Cir. 1985); *In re North Atlantic Millwork Corp.,* 155 B.R. 271, 281 (Bankr. D. Mass. 1993).

19. Finally, there are narrow circumstances where a *creditor* may bring adversary proceedings. One such case is where a trustee has stipulated to the prosecution of estate actions by a creditor on behalf of the estate, and the court has approved that stipulation, the creditor has standing to bring suit to recover estate claims. *Avalanche Maritime, Ltd. v. Parekh (In re Parmetex, Inc.),* 199 F.3d 1029, 1031 (9th Cir. 1999). While it is true that "[N]othing in the Bankruptcy Code dictates that a trustee cannot authorize a creditor to litigate an avoidance action on the trustee's behalf", *McCarthy v. Navistar Financial Corp.*

(In re Vogel Van & Storage, Inc.), 210 B.R. 27, 32 (N.D.N.Y. 1997), it is equally clear that the power to bring such claims may be transferred to a creditor either pursuant to a plan of reorganization under Section 1123 or outside of a chapter 11 plan *when the creditor is pursuing interests common to all creditors. Ducker Spradling & Metzger v. Baum Trust (In re P.R.T.C, Inc.),* 177 F.3d 774, 781 (9th Cir. 1999), *(emphasis added) citing Briggs v. Kent (In re Professional Inv. Properties of Am.),* 955 F.2d 623, 626 (9th Cir. 1992).

20. *Assuming that the Avoidance Recovery Property is still property of the estate,* and *further assuming* that this Court has jurisdiction to hear these avoidance actions and that these claims were not assigned or transferred, but merely are claims that the Plaintiff is pursuing on the Debtors' behalf, the Plaintiff still needs to show whether it is "pursuing interests common to all creditors".

21 Whether analyzed under §1123 (where the party bringing the action does so under a confirmed plan of reorganization as the "representative of the estate") or under §550 (which allows recovery of an avoided transfer "for the benefit of the estate"), a common theme running through cases under both sections is the impact, direct or indirect, the recovery will have upon prepetition unsecured creditors of the estate.[4]

---

[4] Although this case does not involve a confirmed plan of reorganization, (and therefore § 1123 presumably doesn't apply), the cases decided under § 1123 discuss the "representative of the estate" requirement and ultimately focus on "whether the appointed representative's recovery would benefit the estate". *In re North Atlantic Millwork*

(Continued on following page)

"Representative of the estate" under §1123

22. In *In re North Atlantic Millwork Corp.*, 155 B.R. 271 (Bankr. D. Mass. 1993), a post petition financing and cash collateral order granted to the chapter 11 debtor's prepetition lender a first lien in all existing and after acquired property, including all property recovered by the debtor as a result of actions successfully maintained under Bankruptcy Code Sections 543, 550 and 551. In the wake of an impending threat to either convert the case to one under chapter 7 or to appoint a chapter 11 trustee, the Creditors' Committee and the Debtor filed a joint motion to sell all the debtor's assets free and clear of liens. The asset purchase agreement drafted in conjunction with the sale defined "purchased assets" to include Section 547, 548 and 550-avoidance claims. The sale was approved and the sale order authorized the debtor to transfer to the purchaser all causes of action, including the avoidance claims. The purchaser was authorized to bring the avoidance claims even if the case converted to a chapter 7. The purchaser agreed to execute in favor of the debtor a promissory note not to exceed $125,000, plus accrued interest, which would be assigned to the Committee for distribution to the debtor's unsecured creditors.

Even though the purchaser was authorized to bring the avoidance actions not under a confirmed plan pursuant to §1123 but rather pursuant to an order approving the sale of the debtor's assets, the court nevertheless

---

Corp., 155 B.R. 271, 281 (Bankr. D. Mass. 1993). Therefore, although not dispositive. the cases analyzed under § 1123 are instructive.

analyzed the grant of authority under the requirements of §1123, focusing on the second required element of whether the purchaser was "a representative of the estate". There, the court noted that such inquiry starts by "focusing on whether the appointed representative's recovery would benefit the estate". *North Atlantic Millwork,* 155 B.R. at 281. A "benefit" could be indirect – such as recoveries that increase the value of ownership rights that the unsecured creditors have in the debtor's successor. See also, *In re Trans World Airlines, Inc. v. Travellers International AG,* 163 B.R. 964, 973 (Bankr. D. Del. 1994), *see, infra* p. 21-22. However, the *North Atlantic Millwork* court was unable to find even an indirect benefit. Not even the $125,000 promissory note qualified as a benefit to the estate since no payments were due until 1994, and since that sum to be paid to unsecured creditors was neither guaranteed nor secured by collateral. *North Atlantic Millwork,* 155 B.R. at 283. The defendants' motions to dismiss were granted.[5]

23. Conversely, where, under a confirmed plan, the recovery from avoidance actions was to be paid to administrative claimants, thereby enabling the estate to have more funds available to pay other unsecured creditors, this

[5] The *North Atlantic Millwork* case also discussed whether the avoidance claims were "transferred" or inappropriately "assigned" (via sale order instead of chapter 11 plan), and whether the failure of the sale notice to set forth information regarding the transfers of the avoidance claims was in error. Here, there is no assignment of the avoidance claims, but, as the Plaintiff alleges (assuming that the avoidance claims are still property of the estate), it is merely the party designated by the debtor and approved by the Court to pursue the avoidance claims on the debtors' behalf. Nevertheless *North Atlantic Millwork* provides a pertinent discussion with respect to the definition of "benefit to the estate" under § 1123.

potential indirect benefit was found sufficient to fulfill the "representative of the estate" requirement under §1123. Hence, the defendant's motion to dismiss was denied on appeal, and the representative was allowed to proceed with prosecution of the avoidance actions. *In re Sweetwater,* 884 F.2d 1323, 1327 (10th Cir. 1989). Pertinent in the Tenth Circuit's discussion is this observation:

> "The primary concern is whether a successful recovery by the appointed representative would benefit the debtor's estate, and particularly, *the debtor's unsecured creditors".*

Sweetwater, 884 F.2d at 1327 (emphasis added; citations omitted).

The *Sweetwater* court reiterated the purpose behind the avoidance powers under §547 and noted:

> When a debtor corporation has made a transfer of its assets which results in the preference of one or more creditors over others, the purpose of an action against those transferees is to return assets to the debtor's estate for equitable distribution to all creditors . . . [these cases] reaffirm the principle that post petition avoidance actions should be pursued in a manner that will satisfy the basic bankruptcy purpose of treating all similarly situated creditors alike; one or more similarly situated creditors should not be able to pursue an avoidance action for their exclusive benefit . . .

Sweetwater, 884 F.2d at 1327-28.

Benefit to the Estate under §550

24. Once a transfer has been determined to be an avoidance preference under §547 or an avoidance fraudulent transfer under §548, Section 550 (a) of the Bankruptcy Code determines the parties that are liable and to whom a debtor or trustee can look for recovery of such avoided transfers. However, that section conditions recovery on "benefit to the estate", similar to the analysis discussed earlier. Section 550 states: "[ex]cept as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, ***for the benefit of the estate***, the property transferred . . ." 11 U.S.C. §550(a) (emphasis added).

25. It is axiomatic, as well as statutory, that the recovery of preference claims cannot be accomplished unless such recovery is for the "benefit of the estate." *11 U.S.C. Section 550(a); P.A. Bergner & Co. v. Bank One, Milwaukee, N.A. (In re P.A. Bergner & Co.),* 140 F.3d 1111, 1118 (7th Cir. 1998). The objective of the estate benefit requirement is to ensure that actions designed to return transfers from individual creditors who have been "preferred" over other creditors do not have the unintended effect of annulling a just obligation of the debtor to those creditors by benefitting the debtor "*alone.*" Bergner at 1118 *(emphasis supplied).* In other words, the idea is to equalize and enhance the potential for distributions through the estate in accordance with the priorities of the Bankruptcy Code or orders of the Bankruptcy Court and not to afford a windfall for the justly obligated debtor. *Acequia, Inc. v. Clinton (In re Acequia, Inc.),* 34 F.3d 800, 812 (9th Cir. 1994).

26. Like §1123, a "benefit" to the estate need not be direct to satisfy the requirement of §550; an indirect benefit suffices. *In re Trans World Airlines, Inc. v. Travellers International AG,* 163 BR. 964, 973 (Bankr. D. Del. 1994). In *Trans World Airlines,* the chapter 11 debtor brought a §547 avoidance action against Travellers International AG ("Travellers"). Travellers moved to dismiss, in part, on the basis that only the former CEO of the debtor, Carl Icahn, who made substantial loans to the debtor, and who was to be repaid in part, from preference recoveries, stood to benefit from any recovery and therefore, the action should be dismissed because it didn't benefit the estate as required under §550. The Court first noted that, although a comprehensive settlement agreement allowed the debtor to assign the avoidance claims to Icahn, they had not in fact been assigned. More importantly, the court noted that under the confirmed plan,[6] unsecured creditors, in full satisfaction of their claims, received a pro rata share of the principal amount of seven year notes and over 3 million shares of new preferred stock in the reorganized debtor. To the extent the avoidance action was successful, Icahn was to be repaid up to $13,000,000 of the recovery.

In finding an indirect benefit that satisfied the precepts of §550, the court denied the Traveller's motion to dismiss:

> TWA argues, and I agree, that the unsecured creditors will benefit from the enhanced value of reorganized TWA by reason of being shareholders

[6] Although the *Trans World Airlines* case had a confirmed chapter 11 plan (and therefore, could have been analyzed under § 1123), the court focused on the "for the benefit of the estate" language under §550.

> of the reorganized debtor. It is of little moment that the recovery may be immediately paid to Icahn. If a $13 million payment to Icahn does not come out of the recovery, then it will necessarily come out of other TWA assets. I also conclude that not only do the unsecured creditors benefit as shareholders, they benefit as noteholders. To the extent that the recovery will enhance the value of reorganized TWA, the noteholders, as well as other creditors of TWA, will benefit . . . [W]hile these benefits may not be "committed" to the creditors or be quantifiable as to them, the benefits are nevertheless real. More importantly, the benefit to the estate is quantifiable, and *the estate is the focus of §550(a), not individual creditors . . . The basis purpose of a recovery pursuant to §550(a) is to enlarge the estate for the benefit of creditors.*

Trans World Airlines, 163 B.R. at 973. (emphasis added).

27. In *Bergner,* the debtor was pursuing preference and setoff actions against a creditor when its chapter 11 plan was confirmed. Although the confirmed plan contained no specific language of which actions the debtor was going to pursue postconfirmation, the plan was clear that the bankruptcy court retained jurisdiction to hear actions that were pending when the disclosure statement was approved. Having determined that the confirmed plan did not prevent the pending preference action, the Seventh Circuit then analyzed whether the preference recovery would be for the benefit of the estate, a prerequisite to recovery under §550. The defendant argued that, recovery by the reorganized debtor (the plaintiff) would only benefit the new owners of the reorganized debtor and not "the estate".

The Seventh Circuit first reiterated that the benefit contemplated by §550 need not be "direct" and noted that the "benefit to the estate" requirement was interpreted broadly, permitting recovery even where it will not vary the fixed amount unsecured creditors are to receive under a confirmed plan. However, the Seventh Circuit continued:

> Here, we agree that recovery will benefit the owners of the reorganized Bergner. But who are they? Under the plan, 100% of the equity in Bergner was distributed to the holders of the Swiss bank group's approximately $300 million in undersecured claims, *who in exchange funded $25 million of the distribution to general unsecured creditors.* Recovery in this preference action will benefit the reorganized Bergner, as Bank One points out, which in turn will benefit the owners of reorganized Bergner – the largest creditor group of old Bergner. This is enough, in our view, to satisfy the requirements of § 550. *See In re Acequia, Inc.,* 34 F.3d at 811; *In re Trans World Airlines, Inc.,* 163. B.R. 964, 969-71 (Bankr. D. Del. 1994).
>
> (emphasis added).

In *Bergner,* the "bank group", in exchange for receiving 100% of the equity of the reorganized debtor, funded $25,000,000 for distribution to unsecured creditors. Even though the Bergner court interpreted the phrase "benefit to the estate" broadly, such phrase nevertheless connotes that prepetition unsecured creditors either directly or indirectly benefit from the preference recoveries, either through a direct participation in the preference recovery proceeds, through an enhanced value of their equity in a newly *reorganized* debtor, or through the freeing up of funds now available to them that otherwise would have

been paid to the party bringing the preference actions had no recovery been realized.[7]

28. Here, the Plaintiff argues that the requisite "benefit to the estate" was the $30,000,000 postpetition loan. That postpetition loan undoubtedly benefitted the debtor in possession, to the extent it prolonged plant operations in an attempt to increase the value of the debtors as a going concern. However, unlike the situations in either *Bergner* or *Trans World Airlines,* unsecured creditors in this case have received nothing. There was no plan. There was no reorganization, and unsecured creditors have no stake in the success of the reorganized debtor because there is no reorganized debtor. There was no fund established from which proceeds are to be distributed to unsecured creditors. As recovery of the avoidance claims will not reach the $30 million threshold, and the Prepetition Lenders will be the sole beneficiaries of the requested recoveries from Dick Corporation and GE Supply, bringing these action will not inure to the benefit of the estate.

---

[7] Although decided under §1123, *Winston & Strawn v. Kelly, et al (In re Churchfield Management & Investment Corp.),* 122 B.R. 76 (Bankr. N. D. Ill. 1990) affirms this view. There, the Bankruptcy Court noted: "Courts have held that so long as the *unsecured creditors* receive some benefit from the recovery of a preference, even if it is not an actual increase in the amount the creditors will receive, § 1123(b)(3)(B) will still apply." 122 B.R. at 82. Although at least one court has allowed recovery in a case where only the secured lender was to benefit, it was a case where the plan of reorganization provided for a distribution to unsecured creditors, and that distribution was largely possible only through the post petition advances made by the secured lender to the debtor. See, *In re Tennessee Wheel & Rubber Co.,* 64 B.R. 721, 726 (Bankr. M. D. Tenn. 1986).

29. There is no bankruptcy or reorganizational purpose to be served by permitting this action to go forward particularly where, as here, there is no plan, there will be no distribution to unsecured creditors and the bankruptcy case, upon conclusion of these preference actions, will be dismissed. "Where recovery will benefit an entity other that the estate, Section 550's requirement that recovery be for the benefit of the estate is not satisfied." *In re Huntsville Small Engines, Inc.*, 228 B.R. 5, 13 (Bankr. N. D. Ala.1998); *In re Metal Brokers International, Inc.*, 225 B. R. 920 (Bankr. E. D. Wis.1998); *See also In re Burlington Motor Holdings, Inc.*, 231 B.R. 874, 877 (Bankr. D.Del. 1999) (holding that successor corporation which had acquired all of the Chapter 11 debtors' assets lacked standing to bring preference actions, as "any recovery by the Successor Corporation is not for the benefit of the estate as required by §550(a).") *See also Congress Credit Corp. v. AJC Intern.*, 186 B.R. 555 (D.P.R. 1995) (finding no benefit to the estate and party asserting claims has no standing where party asserting preference action had a lien on the proceeds on the recovery of preference actions, requiring proceeds to go directly to that party and where unsecured creditors receive none of the proceeds).

30. Because the Plaintiff has failed to show that there is a genuine issue of material fact with respect to whether the Avoidance Claims are property of the estate, and whether the Plaintiff is entitled to recover the Avoidance Recovery Property under §550, the Court concludes that there is no genuine issue of material fact with respect to these issues, and therefore, summary judgment in favor of the Defendants is appropriate. Accordingly, the issues raised as to Section 547 liability need not be reached.

The appropriate summary judgment entry will follow.

DATE: AUG 06 2001

/s/ Anthony J. Metz, III
ANTHONY J. METZ, III,
Judge
United States
Bankruptcy Court

Distribution:

Andrew P. Brozman/Jennifer DeMarco,
Attorneys for Plaintiff
Charleyne L. Gabriel, Attorney for GE Supply
Martin Weis, Attorney for Dick Corporation
Kevin Dempsey, U.S. Trustee

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

In re: Qualitech Steel Corporation Qualitech Steel Holdings	Case No. 99-3364-AJM-11 Case No. 99-3363-AJM-11 Jointly Administered Under 99-3364-AJM-11
Mellon Bank, N.A. as Collateral Agent for the Prepetition Senior Lenders, on behalf of Qualitech Steel Corporation, Plaintiff, vs. Dick Corporation, Defendant.	Adversary Proceeding No. 00-296
Mellon Bank, N.A. as Collateral Agent for the Prepetition Senior Lenders, Plaintiff, vs. GE Supply Company Defendant.	Adversary Proceeding No. 00-298

ORDER GRANTING DEFENDANTS' MOTIONS FOR SUMMARY JUDGMENT

The Court has entered its Findings of Fact and Conclusions of Law regarding the cross motions for summary judgment filed by the Plaintiff and the Defendants. The Court, having found no genuine issue of material fact with

respect to whether the Avoidance Claims were sold and are no longer property of the Debtors' estates and, in the alternative, (2) whether recovery from these avoidance actions is for the benefit of the estate as required under 11 U.S.C. § 550; and having found as a matter of law that the Avoidance Claims were sold on August 13, 1999, and therefore are no longer property of the estate, and further, in the alternative having found that recovery from these avoidance action [sic] do not meet "for the benefit of the estate" requirement under § 550;

IT IS HEREBY ORDERED, ADJUDGED AND DECREED THAT: Summary Judgment is entered in favor of the Defendants, GE Supply Company and Dick Corporation, and it is further ordered that

the Plaintiff's Motion for Summary Judgment is hereby DENIED.

DATE: AUG 06 2001

/s/ Anthony J. Metz, III
ANTHONY J. METZ, III,
Judge
United States
Bankruptcy Court

Distribution:

Andrew P. Brozman/Jennifer DeMarco,
Attorneys for Plaintiff
Charleyne L. Gabriel, Attorney for GE Supply
Martin Weis, Attorney for Dick Corporation
Kevin Dempsey, U.S. Trustee

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

In re: Qualitech Steel Corporation Qualitech Steel Holdings	Case No. 99-3364-AJM-11 Case No. 99-3363-AJM-11 Jointly Administered Under 99-3364-AJM-11
Mellon Bank, N.A. as Collateral Agent for the Prepetition Senior Lenders, on behalf of Qualitech Steel Corporation, Plaintiff, vs. Dick Corporation, Defendant.	Adversary Proceeding No. 00-296
Mellon Bank, N.A. as Collateral Agent for the Prepetition Senior Lenders, Plaintiff, vs. GE Supply Company Defendant.	Adversary Proceeding No. 00-298

ORDER DENYING PLAINTIFF'S MOTION FOR RECONSIDERATION

The Plaintiff filed its Motion for Reconsideration of the Order Granting Defendants' Motions for Summary Judgment dated August 6, 2001. Hearing on the Plaintiff's

Motion and the Defendants' response was held on December 5, 2001 wherein Andrew Brozman and Jennifer DeMarco appeared for the Plaintiffs; Martin J. Weis appeared for Defendant Dick Corporation; Charleyne Gabriel appeared for Defendant GE Supply. The Court, after reviewing the record, and considering the arguments of counsel, now DENIES the Plaintiff's Motion for Reconsideration.

DATE: DEC 27 2001

/s/ Anthony J. Metz, III
ANTHONY J. METZ, III,
Judge
United States
Bankruptcy Court

Distribution:

Andrew P. Brozman/Jennifer DeMarco,
Attorneys for Plaintiff
Charleyne L. Gabriel, Attorney for GE Supply
Martin Weis, Attorney for Dick Corporation
Kevin Dempsey, U.S. Trustee

Local Bankruptcy Rules
United States Bankruptcy Court
District of Massachusetts

[SEAL]

March 31, 2003

Fifth Edition

United States Bankruptcy Court 1101 Thomas P. O'Neill, Jr. Federal Building 10 Causeway Street, Room 1101 Boston, Massachusetts 02222-1074 (617) 565-8950	United States Bankruptcy Court Divisional Office Harold Donohue Federal Courthouse 595 Main Street Worcester, Massachusetts 01608-2076 (508) 793-0518

* * *

RULE 4001-2. USE OF CASH COLLATERAL, OBTAINING CREDIT AND STIPULATIONS RELATING TO SAME

* * *

(c) Subject to section (d), the following provisions contained in an agreement between the debtor and the holder of a secured claim as to use of cash collateral, obtaining credit, or adequate protection, or any interim or final order approving or authorizing the use of cash collateral, obtaining credit, or adequate protection, shall be unenforceable:

(1) any acknowledgment of the validity, amount, perfection, priority, extent or enforceability of the secured claim, if the agreement or order purports to bind any party other than the debtor,

unless the agreement or order affords an objection period of not less than ninety (90) days after (I) for any party in interest, the entry of the order approving the agreement; (ii) for the creditors' committee, the entry of an order approving the employment of counsel to the creditors' committee; and (iii) for a Chapter 11 or Chapter 7 trustee, the entry of an order approving the employment of counsel to said Chapter 11 or Chapter 7 trustee;

(2) any waiver of defenses by the debtor or estate representative;

(3) any postpetition lien which purports to secure any claim of a secured creditor other than (I) a claim arising from postpetition advances which constitute an additional non-replacement extension of credit; or (ii) a claim representing the diminution in value of the secured claim after the commencement of the case;

(4) any grant of a security interest in avoidance power recoveries available to the trustee;

(5) any provision granting a creditor relief from the automatic stay without further order or hearing upon the breach of the cash collateral, adequate protection or postposition financing order or agreement; or

(6) any waiver by the debtor of the estate representative of rights provided by 11 U.S.C. § 506(c), in whole or in part.

(d) Notwithstanding section (c), the Court may order the enforcement of any terms and conditions on the use of cash collateral or obtaining credit, provided that [i] the proposed order or agreement specifically states that the proposed terms and conditions vary from the

requirements of section (c), and (ii) any such proposed terms and conditions are conspicuously and specifically set forth in the proposed agreement or order.

LOCAL RULES
UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

(Effective February 1, 2001)
(Amended September 1, 2002 to add Rule 3007-1)

* * *

Rule 4001-2 Cash Collateral and Financing Orders

(a) *Motions.* Except as provided herein and elsewhere in these Rules, all cash collateral and financing requests under 11 U.S.C. §§ 363 and 364 shall be heard by motion filed pursuant to Fed.R.Bankr.P. 2002, 4001 and 9014 ("Financing Motions").

(i) *Provisions to be Highlighted.* All Financing Motions must (1) recite whether the proposed form of order and/or underlying cash collateral stipulation or loan agreement contains any provisions of the type indicated below, (2) identify the location of any such provision in the proposed form of order, cash collateral stipulation and/or loan agreement, and (3) the justification for the inclusion of such provision:

* * *

(D) Provisions that grant immediately to the prepetition secured creditor liens on the debtor's claims and causes of action arising under 11 U.S.C. §§ 544, 545, 547, 548, and 549.

* * *

United States Bankruptcy Court
Northern District of Illinois

[SEAL]

Local Rules

Adopted June 1, 2003

* * *

RULE 4001-2

CASH COLLATERAL AND FINANCING ORDERS

A. Motions

(1) Except as provided in these Rules, all cash collateral and financing requests under §§363 and 364 of the Bankruptcy Code shall be heard by motion filed pursuant to Fed.R.Bankr.P. 2002, 4001 and 9014 ("Financing Motions").

(2) Provisions to be Highlighted. All Financing Motions must (a) recite whether the proposed form of order or underlying cash collateral stipulation or loan agreement contains any provision of the type indicated below, (b) identify the location of any such provision in the proposed form of order, cash collateral stipulation or loan agreement, and (c) state the justification for the inclusion of such provision:

* * *

(d) Provisions that immediately grant to the prepetition secured creditor liens on the debtor's claims and causes of action arising under §§544, 545, 547, 548, and 549 of the Bankruptcy Code.

* * *

(3) All Financing Motions shall also provide a summary of all provisions that must be highlighted under section (A)(2) of this Rule and a summary of the essential terms of the proposed use of cash collateral or financing, including the maximum borrowing available on a final basis, the interim borrowing limit, borrowing conditions, interest rate, maturity, events of default, use of funds limitations, and protections afforded under §§363 and 364 of the Bankruptcy Code.

* * *

(5) The court may deem unenforceable any provision not highlighted as required under section (A)(2) of this Rule.

B. Interim Relief

When Financing Motions are filed with the court on or shortly after the date of the entry of the order for relief, the court may grant interim relief pending review by the interested parties of the proposed debtor-in-possession financing arrangements. Such interim relief should only be granted to avoid immediate and irreparable harm to the estate pending a final hearing. In the absence of extraordinary circumstances, the court shall not approve interim financing orders that include any of the provisions previously identified in section (A)(2)(a) through (A)(2)(I) of this Rule.

* * *

Local Bankruptcy Rules, Forms and Procedures

United States Bankruptcy Court
for the Southern District of Ohio

Effective: January 1, 2004

* * *

4001-2 CASH COLLATERAL

(a) Motion. Except as provided herein and elsewhere in these Local Rules, in a chapter 11 case, all cash collateral and financing requests under §§ 363 and 364 of the Code shall be heard by motion filed pursuant to Rules 2002, 4001 and 9014. Stipulations or agreed orders regarding the use of cash collateral are subject to the provisions of this rule. A motion shall contain a description of the cash collateral to be used, sold, or leased; a description of the interest claimed by any other entity in the cash collateral; and the reasons for which the debtor seeks authorization to use, sell, or lease the cash collateral.

(1) Provisions to be Highlighted. A motion must (1) recite whether the proposed form of order and/or underlying cash collateral stipulation or loan agreement contains any provision of the type listed below, (2) identify and highlight the location of any such provision in the proposed form of order, cash collateral stipulation and/or loan agreement, and (3) set forth the justification for the inclusion of such provision. The provisions to be identified and highlighted are:

* * *

(F) Provisions that grant immediately to the prepetition secured creditor liens on the debtor's claims and causes of action arising under §§ 544, 545, 547, 548, and 549 of the Code.

* * *

(b) Interim Relief at Outset of Case. When a motion is filed with the court on or shortly after the date of the entry of the order for relief, the court may grant interim relief pending review of the proposed debtor-in-possession financing arrangements by the interested parties. Such interim relief is intended to avoid immediate and irreparable harm to the estate pending a final hearing. In the absence of extraordinary circumstances, the court will not approve interim financing orders that include any of the provisions previously identified in subsection (a)(1)(A) through (a)(1)(Q) above.

* * *

LOCAL BANKRUPTCY RULES
(Abridged Edition)

EFFECTIVE MAY 1, 2003

[SEAL]

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

Edward R. Roybal Federal Building
255 East Temple Street
Los Angeles, California 90012
(213) 894-3118

LOCAL BANKRUPTCY RULE 4001-2

CASH COLLATERAL STIPULATIONS

Every motion requesting the approval of a stipulation providing for the use of cash collateral (11 U.S.C. § 363(c)), or postpetition financing (11 U.S.C. § 364(c)), or both, shall be accompanied by court-approved form F 4001-2, Statement Pursuant to Local Bankruptcy Rule 4001-2, or a statement consistent with court-approved form F 4001-2.

Attorney or Party Name, Address, Telephone & FAX Numbers, and California State Bar Number

FOR COURT USE ONLY

Attorney for

UNITED STATES BANKRUPTCY COURT CENTRAL DISTRICT OF CALIFORNIA

In re:

CHAPTER ___
CASE NUMBER
DATE:
TIME:
Debtor. COURTROOM:

STATEMENT PURSUANT TO LOCAL BANKRUPTCY RULE 4001-2 (CASH COLLATERAL STIPULATIONS) (Secured Creditor: ___)

The Debtor, through a separately filed motion, has requested the approval of a stipulation providing for the use of cash collateral, or post-petition financing, or both. Attached to the motion as Exhibit ___ is a true and correct copy of the agreement for use of cash collateral or post-petition financing (the "Agreement"), which Agreement contains the following provisions:

Description of Provision	**Page No:**	**Line No. (If Applicable)**
☐ Cross-collateralization clauses	___	___
☐ Provisions or findings of fact that bind the estate or all parties in interest with respect to the validity, perfection or amount of the secured party's lien or debt	___	___
☐ Provisions or findings of fact that bind the estate or all parties in interest with		

respect to the relative priorities of the secured party's lien and liens held by persons who are not party to the stipulation, or which create a lien senior or equal to any existing lien ___ ___

☐ Waivers of 11 U.S.C. § 506(c), unless the waiver is effective only during the period in which the debtor is authorized to use cash collateral or borrow funds ___ ___

☐ Provisions that operate, as a practical matter, to divest the debtor in possession of any discretion in the formulation of a plan or administration of the estate or to limit access to the court to seek any relief under other applicable provision of law ___ ___

☐ Releases of liability for the creditor's alleged prepetition torts or breaches of contract ___ ___

☐ Waivers of avoidance actions arising under the Bankruptcy Code ___ ___

☐ Automatic relief from the automatic stay upon default, conversion to chapter 7, or appointment of a trustee ___ ___

☐ Waivers of procedural requirements, including those for foreclosure mandated under applicable nonbankruptcy law, and for perfection of replacement of liens	___	___
☐ Adequate protection provisions which create liens on claims for relief arising under 11 U.S.C. §§ 506(c), 544, 545, 547, 548 and 549	___	___
☐ Waivers, effective on default or expiration, of the debtor's right to move for a court order pursuant to 11 U.S.C. § 363(c)(2)(B) authorizing the use of cash collateral in the absence of the secured party's consent	___	___
☐ Provisions that grant a lien in an amount in excess of the dollar amount of cash collateral authorized under the applicable cash collateral order	___	___
☐ Provisions providing for the paying down of prepetition principal owed to a creditor	___	___
☐ Findings of fact on matters extraneous to the approval process	___	___

Dated:

Type Name *Signature*

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

JUDGE PETER J. WALSH

824 MARKET STREET
WILMINGTON, DE 19801
(302) 573-6272

April 2, 1998

RE: First Day DIP Financing Orders

Dear Delaware Bankruptcy Counsel:

This is a follow-up to our session of March 11, 1998, where, at the prompting of Judge McKelvie, we discussed the need for improving the DIP financing orders being submitted at first day hearings. At that meeting, I gave a number of examples of provisions in several orders that I thought were either unnecessary, overreaching, or just plain wrong. In an effort to improve the content of first day DIP financing orders, I volunteered to comment in writing on the forms and to identify a number of terms or provisions in those orders that I believe should be avoided.

The following items, in no particular order of priority (except as to the first item), are not intended as immutable rules that I have on the matter, and certainly I have no authority to speak for the other judges on these matters, but I thought if we could shorten and eliminate some of the more objectionable features of proposed first day DIP financing orders, we could improve the first day proceeding. Needless to say, however, I think it is not practicable to have a blanket set of prohibitions given the numerous variations in the lending arrangements and the prepetition relationships between the debtor and the lender(s).

1. Many of the proposed orders are just too verbose and cover unnecessary matters. It is not necessary for the order to recite, even in summary fashion, the major provisions of the loan documents. For example, the following is a portion of a paragraph included in a recent DIP financing order, which obviously paraphrases what the loan document says on this particular matter:

> All advances and other extensions of credit and financial accom[m]odations shall be made solely on the terms and conditions of, and pursuant to, the Postpetition Loan Agreement and the other Postpetition Loan Documents, shall be evidenced by the Lenders' books and records, and shall be due and payable as provided in those agreements. The Lenders shall have no commitment to make any advances or other extensions of credit or financial accom[m]odations, and may, at any time, refuse to make advances, extensions of credit, or other financial accom[m]odations and may exercise their rights and remedies pursuant to the Prepetition Loan Agreement, the Postpetition Loan Agreement, and this Order upon an Event of Default as provided in the Postpetition Loan Agreement, including, without limitation, the incurrence by the Debtors of any liabilities above those approved in the "Budget" (as defined herein) appended hereto as Exhibit B.

If the DIP financing order authorizes the debtor to enter into the financing pursuant to the loan documents, it is simply not necessary for the order to restate a lot of the major terms of the financing. (Indeed, most of the above-quoted statement states the obvious for the type of loan transactions that we see on the first day.) The motion itself should spell out the terms that are essential to an understanding of the deal: maximum borrowing, interim

borrowing limit, borrowing conditions (e.g., percentage of inventory value), interest rate, maturity, events of default, use of funds limitations, collateral, and/or priority, etc.; but I do not see that it is necessary to get into a lot of details on these in the order. Of course, the order should identify those sections of the Bankruptcy Code designed to protect the estate and/or creditors generally that are being limited or abridged in any manner by the terms of the loan documents.

2. Do not incorporate into the order specific sections of the loan documents without a statement of the section's import. In a recent case the proposed order contained a decretal paragraph regarding events of default that specifically referenced about a dozen particular sections of the loan agreement and tied them into the issue covered by the decretal paragraph. It is simply unrealistic to expect that I can fully read and digest all the provisions of the loan documents in the few hours those documents are in my possession leading up to the first day hearing. Reciting specific ties between the terms of the order and particular terms or provisions of the loan agreement is something that under most circumstances on the first day I cannot comfortably append my signature to.

3. Given the limited amount of time we have to review the first day motions prior to the hearing and given the substantial amount of paperwork presented, particularly the DIP financing motion with the loan documents and the related order, it is not realistic to have a provision in the order that recites that the Court has "examined" all the loan documents, or that the Court "approves" all the terms and provisions of the loan documents, or language of similar import. An egregious example in this regard reads: "The provisions of the Postpetition Loan Agreement and

other Postpetition Loan Documents are hereby approved and by this reference incorporated herein as a part of this Order." Remember, the Court is authorizing the debtor to borrow money on basic terms that appear reasonable under the expedited circumstances; it is not placing its imprimatur on the multiple terms and conditions of the loan documents.

4. Many of the proposed orders contain lengthy recitations of findings that are preambles to the decretal portion of the order. Given the fact that at most first day hearings only the debtor is heard, it is somewhat presumptuous, and in many cases unduly aggressive, for counsel to hand up an order that sets forth detailed, and in many cases nonessential, findings by the Court regarding prepetition deals, relationships, and understandings of the parties. Most of these findings are based on lengthy recitations in the motion papers. It seems to me, given the limited nature of the first day hearing, that most of these "findings" would better be recited under a heading of "stipulations" between the debtor and the lender. Please note, if the stipulation approach is used, do not put further back in the order a decretal statement that says something to the effect that all the terms and provisions of the subject order constitute an order of the Court. By its nature the order will be acknowledging the stipulations, and of course, appropriate court findings will be a part of the order.

5. The order should not state that parties in interest have been given "sufficient and adequate notice" of the motion. Nine times out of ten this is simply not true. Rule 4001(c)(2) contemplates an expedited hearing with little or no notice (at least not the type of notice that would be sufficient to prepare for an effective participation by third

parties). Consequently, the order should simply recite that the hearing is being held pursuant to the authorization of Rule 4001(c)(2) and recite to whom and when the notice was given.

6. Given the limited nature of the hearing on the first day, the findings that are necessary for the § 364(e) protection afforded the lender can appropriately be expressed in language such as: "Based on the record presented to the Court by the Debtor, it appears that . . . ."

7. Absent exigent circumstances, neither the loan documents nor the order should give the lender a lien position on avoidance actions.

8. While, in order to give the prepetition/postpetition creditor protection typically demanded, it is appropriate for the debtor to acknowledge the validity, perfection, enforceability, and nonavoidability of the prepetition indebtedness and perhaps waive any lender liability claims, this provision should preferably be in the form of a stipulation and should be limited to the debtor so that it is not binding on the estate, the committee, or a trustee. As discussed below, a time limit with respect to nondebtor challenges to the prepetition secured position may be appropriate.

9. Where a DIP financing facility includes the use of the prepetition creditors' cash collateral, adequate protection in the form of a substitute lien on postpetition collateral is appropriate to the extent there is a diminution in the value of the prepetition collateral, but such a provision should not include language such as the following: "[T]he Debtors' use of cash collateral pursuant to this Order or otherwise is hereby deemed to result in a dollar-for-dollar decrease in the value of the Prepetition Collateral . . . ."

10. The debtor's obligation to reimburse the lender for costs and expenses, including attorneys' fees, etc., should be expressed in terms of "reasonable" costs and expenses and such reimbursement obligation should not apply to the lender's defense to challenges by a committee to the lender's prepetition security position.

11. Carveouts for professional fees should not be limited to the debtor's professionals, but should include the professionals employed by any official committee. While the carveout for professionals of any official committee may appropriately exclude work related to the prosecution of an objection to the prepetition secured position of the lender, that exclusion should not encompass any prechallenge investigative work by the professionals.

12. The carveout for committee professionals and the limited period to challenge the lender's prepetition secured position is important. In my view it is the price of admission to the bankruptcy court to obtain the benefits of preserving the assets of the estate, which preservation typically first benefits secured parties.

13. The period of time during which the creditors' committee should have the right to challenge the lenders' prepetition position should generally be at least sixty days from the appointment of the committee. Unless the case is on a fast track, this period should be ninety days.

14. The following provision is patently objectionable:

> Nothing contained in this Order shall be deemed a finding with respect to adequate protection (as that term is described in Section 361 of the Code) of the interest of the Lenders in the Prepetition Collateral, but shall [sic] the Lenders' and security interests in the Prepetition

> Collateral require adequate protection, *Lenders shall be deemed to have requested and shall be deemed to have been granted* such adequate protection as of the Petition Date or such later date when such liens or security interests first were not adequately protected. [Emphasis added.]

15. The following provision is also patently objectionable:

> Notwithstanding anything to the contrary contained in this Order or in any of the Postpetition Agreements, the commitment of the Lenders to make loans, extend credit, and grant other financial accommodations to the Debtors shall *terminate immediately* and automatically, without notice of any kind, *upon the institution by any person or entity of any action seeking to challenge* the validity or priority of (or to subordinate) any of the Lenders' liens or security interests on any of the Prepetition Collateral. [Emphasis added.]

16. I know of no basis for including in a financing order a finding (recently proposed) such as the following: "The Debtor's other secured creditor(s) is/are adequately protected from any adverse consequences which might result from the consummation of the proposed postpetition secured financing between the Debtor and Lender."

17. In reciting the protection afforded the lender by § 364(e), verbose and redundant provisions such as the following are to be avoided. Furthermore, in the following quoted material the underscored language suggests to me that prepetition debt was intended to be afforded the § 364(e) protection. No such effect would be proper.

> If any or all of the provisions of this Order or the DIP Financing Agreement are hereafter modified, vacated or stayed by subsequent order of this Court or by any other court, such stay, modification, or vacation shall not affect the validity of *any debt* to Lender that is or was incurred pursuant to this Order *or that is or was incurred prior to the effective date of such stay, modification, or vacation*, or the validity and enforceability of any lien, security interest or priority authorized or created by this Order or the DIP Financing Agreement and notwithstanding such stay, modification, or vacation, any obligations of the Debtor pursuant to this Order or the DIP Financing Agreement arising prior to the effective date of such stay, modification or vacation shall be governed in all respects by the original provisions of this Order and the DIP Financing Agreement, and the validity of any such credit extended or lien granted pursuant to this Order and the DIP Financing Agreement is subject to the protections afforded under 11 U.S.C. § 364(e). [Emphasis added.]

18. Provisions that operate expressly or as a practical matter to divest the debtor, or any other party in interest, of any discretion in the formulation of a plan are not viewed with favor. I believe the lender can appropriately protect itself without attempting to dictate what may happen with respect to a plan. For example, the lender can certainly include a loan provision calling for repayment in full on the plan's effective date.

19. I often find that the record established at the hearing, either by affidavit or live testimony, is rather thin relative to the detailed findings that the Court is called upon to make. It is important that the affidavit or the live

witness (either by testimony or, if appropriate, by proffer) offered in support of the motion be specific and complete regarding the findings required with respect to §§ 364(c) and (e) and Rule 4001(c)(2).

20. The lifting of the § 362 automatic stay upon the event of a default should be conditioned upon providing three to five business days' notice to the debtor, the U.S. Trustee and any official committee.

21. The order should be worded in a manner that makes it clear that, whatever the terms of the interim order, the Court is not precluded from entering a final order containing provisions inconsistent with or contrary to any of the terms of the interim order, subject, of course, to the lender's § 364(e) protection with respect to monies advanced during the interim period. Just by way of example, should the Court deem it appropriate, given a strong showing at the first day hearing, to allow a waiver of § 506(c), if the subsequently appointed committee presents a persuasive argument, the Court should revisit the matter and be guided by what it hears at the final hearing.

The items discussed above are not intended to be a complete list of the matters that need to be addressed on the issue of first day DIP financing orders. For the most part, they are derived from the latest four or five first day DIP financing orders that I have had before me. If I were to go back over the last few years and review other such orders, I am sure that I could pick out additional provisions that could be considered objectionable.

In any event, I hope that this communication will serve to give counsel sufficient incentive to make the proposed DIP financing orders more palatable while at the same time preserving those elements of the orders that the

lending institutions reasonably believe are essential. Perhaps further dialogue on the matter would be appropriate at a gathering similar to that of the March 11 session.

Very truly yours,

/s/ Peter J. Walsh
Peter J. Walsh

PJW:vw

cc: Chief Judge Joseph J. Farnan, Jr.
Judge Sue L. Robinson
Judge Roderick R. McKelvie
Patricia A. Staiano, United States Trustee